

Senate Select Committee on Superannuation and Financial Services

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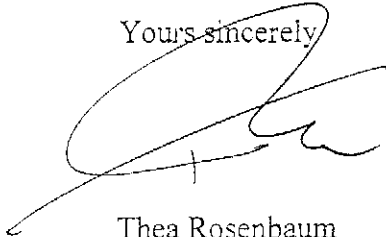
Ms Sue Morton
Secretary
Senate Select Committee on Superannuation
and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Ms Morton

QUESTIONS ON NOTICE – HEARING OF 9 FEBRUARY 2001

Attached is APRA's response to the Questions on Notice taken by Mr Phelps and Ms Rosenbaum when they appeared before the Committee on 9 February 2001.

Yours sincerely



Thea Rosenbaum
Company Secretary



ATTACHMENT 1

ANSWERS TO QUESTIONS ON NOTICE FROM SENATE SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES HEARING OF 9 FEBRUARY 2001

1. What are the current charges or actions against the directors of EPAS? Are they under the Corporations Law or Superannuation Industry (Supervision) Act (SIS Act)?

The attached statement (Attachment 2) released by ASIC on 20 April 2000 details the civil proceedings initiated by ASIC at that time. The pleadings filed by ASIC, which it has advised were provided to the Committee, contain allegations of breaches of both SIS and the Corporations Law. It is APRA's understanding that no criminal charges have been laid to date against the directors or former directors of EPAS.

As it is more efficient for one organisation to progress all actions, APRA is supporting ASIC's proceedings with documents and other resources.

2. What is the degree of complexity and what are the triggers for accessing the compensation provisions under the SIS Act?

Part 23 of the SIS Act requires that the fund makes application to the Minister and that the Minister is satisfied that:

- the fund has suffered an "eligible loss"; that is, a loss suffered because of fraudulent conduct or theft. In the case of a defined benefit fund, an eligible loss means a loss suffered due to fraud or theft which an employer sponsor cannot make up while remaining solvent; and
- the public interest requires the payment of assistance to the fund.

The Minister is required to seek advice from APRA and the decision to grant assistance may be subject to conditions.

To date, there has been only one application for assistance under Part 23 of the SIS Act, from the trustee of the Australian Independent Superannuation Fund (AISF) in Perth. That application is presently on hold at the request of the acting trustee, pending final determination of the extent of the loss due to fraud or theft, and the outcome of recovery actions instigated on behalf of the fund against potentially liable parties.

The issues of the standard of proof as to whether a loss is due to fraud or theft, and the assessment of whether the public interest requires the payment of assistance, have never been decided.

The legislation does not specify a criminal conviction for fraud or theft as a pre-condition for the Minister to form a view that a loss is an eligible loss. The test is whether the Minister is satisfied on the balance of probabilities that the loss is attributable to fraud or theft.

It is inappropriate for APRA to speculate on whether evidence led in civil actions commenced against directors in a particular instance such as EPAS would be sufficient to demonstrate fraud or theft for the purposes of Part 23 of the SIS Act.

The test as to what the public interest may require is more problematic, and more subjective. The key consideration in APRA's view is that public confidence in the overall structure of long term saving for retirement through a private sector superannuation industry should not be called into question by losses due to fraud or theft.

APRA emphasises that the legislation does not contemplate compensation for losses from poor investment decisions. There are likely to be circumstances in which negligence on the part of trustees might be considered to be tantamount to fraud but not meet the legal definition of fraud or theft.

3. Case study of Australian Independent Superannuation Fund (AISF).

Lindsay Dods, one of the two trustee directors of the superannuation fund who also acted as the Fund manager, was jailed in December 2000 for 6 years after pleading guilty to 19 charges relating to the theft of \$240,399 over a period of about 5 years. He first confessed to these thefts to his fellow director on or about 25 June 2000.

The Fund was established in June 1994 and as at 30 June 1998 had 144 members and total assets reported to be \$529,689. These figures derive from the most recent annual return of the fund lodged with APRA. Current membership is approximately 160. Because of the fraud and the state of the accounting records, the current assets cannot be readily determined. APRA replaced the former trustee on 29 August 2000 on the basis that its conduct had led to the fund being in an unsatisfactory financial position. The Acting Trustee is Denara Nominees Pty Ltd; a company associated with the accountancy firm of PricewaterhouseCoopers.

The Acting Trustee is still in the process of reconstructing fund records for the past 6 years, and is actively pursuing recovery options against Dods and the former auditor to the fund. Other options are also under consideration. The reconstruction of records is expected to be finalised imminently, and members will then be asked to confirm their accounts. The fund has ceased accepting contributions, and has frozen assets. It has not received any application for release on the grounds of death or retirement, or for early release on compassionate grounds or because of financial hardship.

On 11 August 2000, Broadway Fiduciary (the former Trustee) made an application for financial assistance to the Fund under Part 23 of the Superannuation Industry (Supervision) Act 1993 (the 'SIS Act'). The basis of the application is that the fund was, in certain instances, unable to meet payments to members as a result of Dods' fraudulent conduct. The Acting Trustee has asked that consideration of this application be deferred until it has determined the full extent of the losses, and it has exhausted avenues for recovery of members' losses from Dods and other parties whose conduct had contributed to the fraud continuing undetected over such an extended period. The recovery sought will include costs incurred by the fund due to the appointment of the Acting Trustee. The Minister will consider the application for financial assistance at that time, and will make a decision after obtaining advice from APRA, as required under the law.

It is too soon to estimate what the likely success of Denara's recovery actions may be. APRA is working closely with the Acting Trustee and other interested parties to resolve this matter.

By application to the Federal Court, the former Trustee has sought a review under the Administrative Decisions (Judicial Review) Act of the decision to remove it. The matter is expected to be heard around the middle of this year. The application is being vigorously contested by APRA, and by the Minister as the second respondent.

4. What alternatives are available for people waiting after their retirement to receive payments from distressed superannuation funds? Are fund members being prejudiced by the various legal and other actions of regulators?

Where a replacement trustee has been appointed to a superannuation fund, it is open to APRA to issue directions to the replacement trustee under s143 of the SIS Act. It is feasible for APRA to direct a replacement trustee to make payments to members who were retiring from a distressed super fund, even where there was a general freeze on rollovers and withdrawals.

In practice, this has not been required. In the case of EPAS, despite the general freeze on movement out of the fund, the new trustee has been making payments of members' accrued entitlements on death or retirement, and is providing early release of benefits where members qualify. Records of such exited members are held in the fund's records, to enable further payment to them in the future if recovery action against various parties associated with EPAS is successful. The new trustee in the case of EPAS proposes to approach the court for directions on how any proceeds of recovery action should be distributed between current and former members.

In the case of AISF the replacement trustee has imposed a freeze on rollovers and withdrawals. It has not received any request for payment of a retirement or death benefit, nor for the early release of a benefit on compassionate or financial hardship grounds. It has indicated that it would be likely to pay a conservative pro rata amount in the event that such a request were received, pending the full assessment of the assets of the fund. It would maintain records of such payments to enable a further distribution if funds became available from recovery actions.

5. What has been the sequence of notifications to members of EPAS? There have been complaints that members have not been kept informed.

EPAS Ltd advised APRA on 7 August 1998 of a significant adverse event; namely the large negative return brought to book in the 1997-98 year, and the subsequent freeze on withdrawals. EPAS Ltd advised members of this in a letter dated September 1998, and also advised that the fund was closed to new members and that it would seek to transfer members to a successor fund.

Following legal advice, EPAS Ltd decided that the successor fund option was not viable, and it advised members of this in December 1998. It issued a detailed report to members on 31 January 1999 advising them of its revised plans to re-open the fund to new members, conduct a sale of assets using external professional advice, continue the freeze on pre June 1998 contributions but allow all post-July 1998 contributions to be rolled out of the fund at the request of the member.

EPAS Ltd resigned as trustee of the fund in favour of Trust Company Superannuation Services Ltd (TCSSL) with effect from 21 May 1999. TCSSL wrote to members on 7 July 1999 advising of its appointment and that it would:

- Implement a program to market the property portfolio to restore liquidity to the fund;
- Revise the investment strategy;
- Review the freeze on transfers; consider the structure of the fund to facilitate growth and expansion; and
- Issue a new fund information booklet as at 1 July 1999.

TCSSL issued a media release on 22 October 1999 which was also mailed to all members. It advised of its appointment as trustee, its proposals to improve the viability of the fund and the introduction of member investment choice from 1 July 1999, the implementation of the asset realisation program and the handling of pre-1 July 1998 member balances.

Member statements and fund annual reports for the year ended 30 June 1999 were mailed on 4 January 2000. The annual report gave a broad summary of the state of play of the fund's investments and discussed the asset realisation program. In the section on individual investments exceeding 5% of total assets, O'Hara's was identified as "Resort Hotel" with an independent valuation of \$2.6 million or 13.8% of total assets. Neither it nor the other property based assets which individually represented more than 5% of total assets were identified by name "due to the commercial sensitivities of these investments". The report advised that the crediting rate had been set at negative 13.75% for balances at 30 June 1998, and positive 3.25% for contributions received after that date.

Member statements and the fund annual report for the year ending June 2000 were mailed to members on 15 December 2000. The report included, inter alia, that:

- ASIC commenced action in the name of TCSSL on behalf of members, and was seeking damages in excess of \$10 million.
- The distribution of any money awarded by the court will be the subject of an application by the Trustee at the end of the proceedings as to the means and methods of distributing the compensation to fund embers.
- The asset freeze for fund members as at 30 June 1998 would continue, subject to review by the Board at 6 monthly intervals but is likely to continue until the asset realisation program is complete.
- The trustee had introduced member choice of investment strategy, with the default strategy being capital stable.

The report identified four single investments as each representing more than 5% of fund assets. These were Sarina Property Trust (13.3%), EPAS Investment Trust (11.4%), Capital Stable Pool (44.1%) and cash at bank (13.5%). The fund had accumulated reserves of \$772 thousand, or 3.86% of fund net assets. The annual report did not specifically identify the sale of the OHara's Resort property. However, it did note that members with enquiries or complaints should address them to the fund administrator. A postal address and phone and fax numbers were provided. It would be unusual for a superannuation fund trustee to provide specific detail on investment transactions in the course of a year.

6. Does the reporting to members of EPAS show two different accounts – one which pre-dated June 1998 and one post June 1998?

The member statement shows a single balance in the member account as at 30 June of the relevant year, and for comparative purposes the balance at 30 June of the preceding year. It also shows amounts deducted for tax, the administration fee and the group life insurance premium where appropriate. It does not separately list the pre- and post- 30 June 1998 amounts. TCSSL advises that these figures are available to members on request. For 1999-2000 year, the same crediting rate was applied to pre- and post- 30 June 1998 balances. For members in the default capital stable pool, that rate was 5.0%.



ASIC

Australian Securities &
Investments Commission

ASIC SEEKS \$10 MILLION FROM EPAS, DIRECTORS AND AUDITOR.

The Australian Securities and Investments Commission (ASIC) today began civil proceedings in the Queensland Supreme Court against EPAS Ltd, its directors and the 1995-96 auditors of the superannuation fund for which EPAS acted as trustee.

ASIC is seeking damages of more than \$10 million, plus interest, to be returned to the members of the EPAS public industry superannuation fund.

The Supreme Court proceedings were the result of an ASIC investigation into losses incurred by the Employees Productivity Award Superannuation Fund (the EPAS fund) during the time EPAS was trustee of the fund.

EPAS has 26,000 members, most of whom are young workers in the hospitality industry, who are believed to have lost 51 per cent of their entitlements.

EPAS fund members' benefit accounts were frozen in August 1998 minimising any further losses to the members.

ASIC has alleged that from 1994 to 1999, EPAS and its directors gave approval for assets of the fund to be invested in mortgage loans which included:

- imprudent and speculative trustee investments;
- loans which were not made on an "arms length" basis because there were undisclosed fees and profit sharing interests of directors;
- loans which were not always based on independent valuations;
- loans which were not based on a reasonable debt to equity ratio;
- loans which were approved without adequate security or borrower inquiries;
- loans approved in the absence of an investment strategy which complied with the law relating to superannuation funds

EPAS resigned as trustee in May 1999 and was replaced by the current trustee, Trust Company Superannuation Services Limited. This present trustee has carried out a review of the EPAS fund and has focussed on maximising the fund's assets.

ASIC and the Australian Prudential Regulation Authority (APRA) have been working to ensure all efforts are being made to protect the remaining assets of the fund and APRA supports ASIC in bringing these court proceedings.

ASIC action against EPAS is under the ASIC Law which allows it to start an action in the public interest on behalf of the past and present trustee.

ASIC will be seeking declarations that EPAS Limited and its directors must restore trust assets in excess of \$10 million plus interest which was lost or diminished as a result of investment decisions made between 1994 and 1998.

ASIC has alleged that Gold Coast auditors Head, Cheel, Thompson were negligent in the preparation of their 1995 and 1996 EPAS audits.

ASIC also alleges Head, Cheel, Thompson's audit work did not comply with Australian Auditing Standards and the amounts at which investments and related accrued interest was disclosed in the superannuation fund accounts was materially overstated.

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