
**REVIEW OF THE TRIO CAPITAL FRAUD
AND ASSESSMENT OF THE REGULATORY
FRAMEWORK**

Department of Treasury

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Abbreviations

AAM	Astarra Asset Management
ADI	Authorised Deposit-Taking Institution
AFM	Astarra Funds Management Pty Ltd
AFSL	Australian Financial Services Licence
ASF	Astarra Strategic Fund
APRA	Australian Prudential Regulation Authority
APRA Act	<i>Australian Prudential Regulation Authority Act 1998</i>
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
BVI	British Virgin Islands
DPA	Deferred Purchase Agreements
FOS	Financial Ombudsman Service
FoFA	Future of Financial Advice
GDP	Gross Domestic Product
MIS	Managed Investment Scheme
PDS	Product Disclosure Statement
PJC	Parliamentary Joint Committee on Corporations and Financial Services
PST	Pooled Superannuation Trust
RE	Responsible Entity
RSE	Registrable Superannuation Entity
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>
SMSF	Self-Managed Superannuation Fund
WGI	Wright Global Investments Pty Ltd

Executive Summary

Australia's superannuation sector is presently valued at around \$1.5 trillion which represents around 100 per cent of gross domestic product (GDP). With further planned increases in the contribution rate, the value of superannuation assets is projected to exceed 160 per cent of GDP by 2050. It is important that the public has confidence in Australia's superannuation system.

Further to the Parliamentary Joint Committee (PJC) inquiry into the collapse of Trio Capital, and on request from the Minister's Office, Treasury has undertaken a review of the Trio Capital fraud and an assessment of the regulatory framework.

Primary responsibility for the prudent management of superannuation funds lies with the trustees of the superannuation fund; either trustees regulated by the Australian Prudential Regulation Authority (APRA) or self-managed superannuation fund (SMSF) trustees. Where investors choose to opt out of the APRA regulated system by establishing a SMSF, it is important that SMSF trustees also understand that they have responsibility for managing the risks associated with their investments.

The Trio Capital fraud was highly complex in nature. Based on available evidence, the fraud originated with the establishment of a managed investment scheme (MIS). Trustees, directors and investors alike were continuously deceived throughout the operation of the MIS, in respect of the actual existence of underlying assets and the supposed rates of return on investments.

Notwithstanding the conduct of some financial planners in Australia who appear to have been influenced by high commissions in recommending their clients into Trio Capital products, the fraud largely took place in off shore hedge funds. Australian superannuation funds and managed investment schemes regularly invest overseas; however, a key risk of investing overseas is that those jurisdictions may be subject to less stringent regulatory regimes than Australia.

The impact of the Trio Capital collapse has had a significant and detrimental impact on a number of Australian investors. The extent of personal losses suffered by investors was greatest amongst SMSFs. In some instances SMSF trustees had 100 per cent exposure to the fraudulent assets. Overall, regulated superannuation funds had lower exposures to the fraudulent MIS due to higher levels of investment diversification — as required by APRA — than their SMSF counterparts.

In their supervision of Trio Capital there was no evidence to alert the Australian Prudential Regulation Authority (APRA) or the Australian Securities and Investments Commission (ASIC) that there was a fraud occurring. However, once sufficient information was available and formal investigations commenced, APRA and ASIC acted quickly. Nevertheless there appears to be an expectations gap within the community about the regulatory responsibilities of APRA and ASIC and their ability to safeguard against all investment risks as well as an expectations gap within the community about who is responsible for managing investment risks for SMSF trustees.

Chronology of Key Regulatory Events

The following timeline sets out the key regulatory events in relation to Trio Capital.

TIME	REGULATORY ACTION
2004	Licensing of Trio Capital as the responsible entity (RE) of 28 managed investment schemes.
2005	At APRA's request, the Board of Trio Capital RSE is restructured to include a majority of independent directors.
2006	Licensing of Trio Capital as the registrable superannuation entity (RSE) of four superannuation funds.
2006 — 2007	APRA conducts annual review of superannuation funds. Trio Capital acts upon APRA's recommendations to improve its internal governance.
2008	APRA seeks additional valuation information of the underlying assets of some Trio Capital funds as part of its annual review. In late 2008, APRA received some of the valuations previously requested during this period.
March 2009	APRA follows up on request for additional valuation information with the RSE.
June 2009	APRA conducts on-site visit to Trio Capital.
June 2009	ASIC undertakes a general review of hedge funds. Approximately 100 hedge funds (out of around 650) are short-listed for closer examination. ASF is one of the hedge funds short-listed.
Sept 2009	ASIC receives information from a market participant who has analysed ASF returns. ASIC notifies APRA of its concerns with Trio Capital.
Oct 2009	ASIC and APRA commence investigations into Trio Capital. ASIC issues an interim stop order on the PDS for ASF. APRA issues notices to freeze the assets of all four superannuation funds invested in Trio Capital.

Managing Investment Risks

The regulatory framework applying to the financial system provides an additional level of external scrutiny to financial institutions over and above that provided by an institution's board or senior management and through general financial market discipline. The regulatory framework that applies to the superannuation sector recognises that ultimate responsibility for investment decisions and for managing the risks associated with those decisions is a matter for trustees. Regulation of superannuation therefore recognises that risks may arise due to its market linked nature where superannuation funds are able to invest on the open market with gains (and risks) accruing to individuals. Investment options that superannuation fund members choose will impact on the level of their superannuation returns over time and the appropriate investment allocation for individual fund members varies based on a number of factors such as age, life expectancy, length of time to retirement, assets held outside of superannuation and an individual's tolerance for risk.

Superannuation in Australia is generally operated in a trust structure, where the trustee holds the superannuation assets of the trust on behalf of its members and owes a fiduciary duty to act in the best interests of those members. In its regulation of superannuation funds, APRA focuses on ensuring that those trustees adopt good governance practices and that they have in place adequate risk management strategies. APRA requires trustees to identify all the key risks to which its superannuation fund is exposed. These risks can include, market risk, credit risk, liquidity risk and importantly, related-party risk which is the risk that an institution will suffer, directly or indirectly, from losses incurred or by the actions taken by its associated entities. Each institution must have a robust system of controls to monitor and manage those risks and then must ensure that those systems of control are active and operating effectively.

The regulatory framework for superannuation also recognises that some Australians would prefer to take personal responsibility for their superannuation and would prefer to make investment choices themselves via a self-managed superannuation fund (SMSF). Trustees of SMSFs are required to have in place an appropriate investment strategy and are responsible for ensuring they have in place adequate risk management strategies. This includes ensuring that they understand the types of risks they are exposed to, in particular related-party risk and that they have in place mechanisms to minimise these risks, such as through investment diversification. In the case of Trio Capital, submissions to the PJC inquiry indicate that some SMSF trustees were unaware that their superannuation was in a SMSF and hence that they were responsible for their investment decisions and were responsible for mitigating associated risks. In such cases, the role of any financial adviser that recommended the establishment of a SMSF may be called into question.

A lack of investment diversification by many SMSF trustees who invested in Trio Capital products is also likely to have been a contributing factor to the extent of losses suffered by those SMSF trustees. Submissions to the PJC inquiry suggest that a number of SMSFs were entirely invested in the Astarra Strategic Fund (ASF). Furthermore, submissions indicate that some SMSF trustees may have borrowed additional funds against their homes or other collateral to further increase their exposures to the ASF. In contrast, the APRA regulated superannuation funds managed by Trio Capital were all diversified across a range of investments. As such, even though they lost all of their investments in the ASF, the average loss to the APRA regulated superannuation funds was only around 20-25 per cent of total fund assets.

Again, where investments by SMSF trustees were made without regard for investment diversification and as a result of poor financial advice, the conduct of the financial planner may be called into question. ASIC has already taken action against some advisers and one action is currently before the Administrative Appeals Tribunal. Complaints against a number of financial advisers have

also been made with the Financial Ombudsman Service (FOS) which is the ASIC approved External Dispute Resolution scheme.

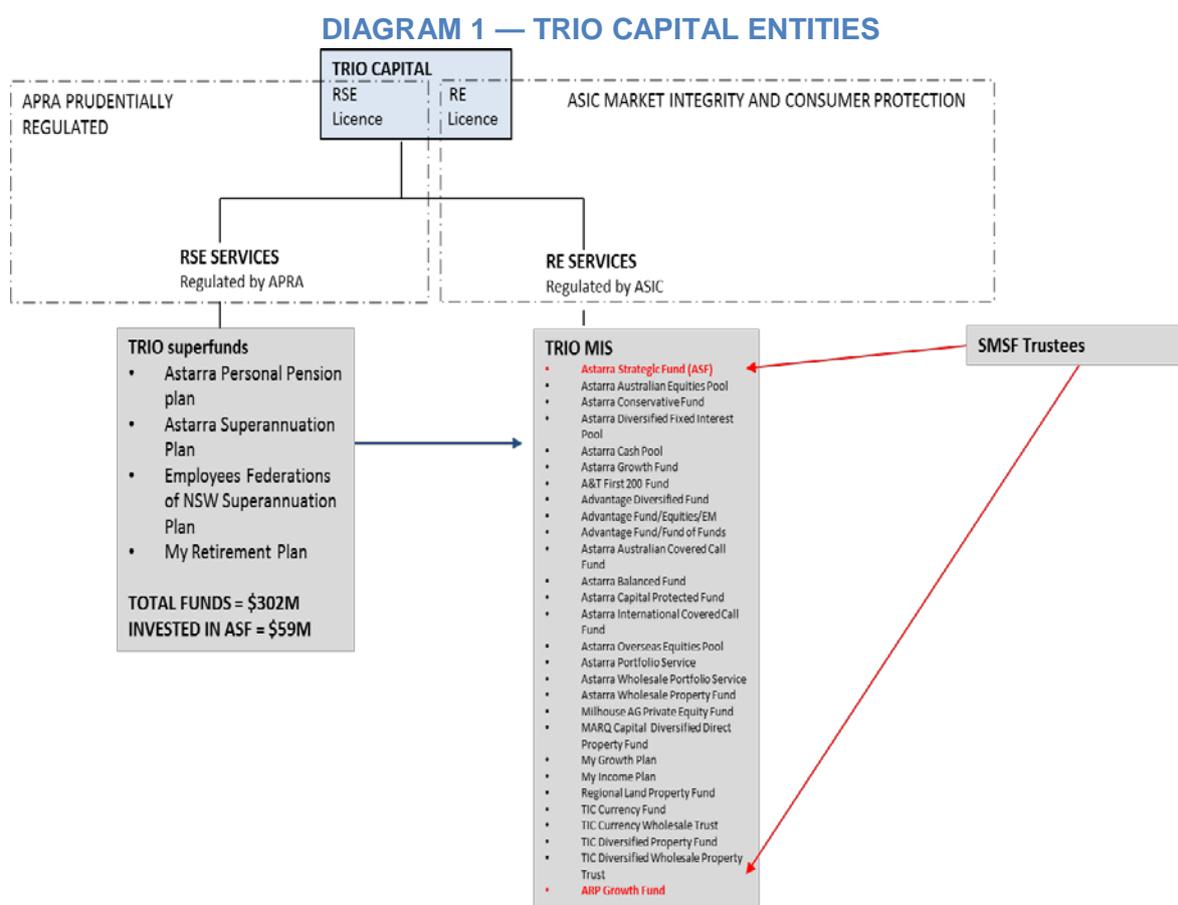
Overall Australian investment fund managers manage around \$1500 billion of assets, of which almost \$248 billion or 17 per cent of assets are invested in offshore assets. In this context, the total loss by investors due to Trio Capital fraud represents less than 0.01 per cent of total managed fund assets. However, for those who were disproportionately exposed to the ASF, the losses were significant.

While it is not possible for any regulatory regime to prevent all risks of potential theft or fraud, the best way to prevent such cases in the future is to ensure that investors understand that all investments are subject to a trade-off between risk and potential reward. And in the case of SMSF trustees, that they understand that they do not have access to compensation in the same manner as APRA regulated superannuation funds.

Collapse of Trio Capital

Key Entities

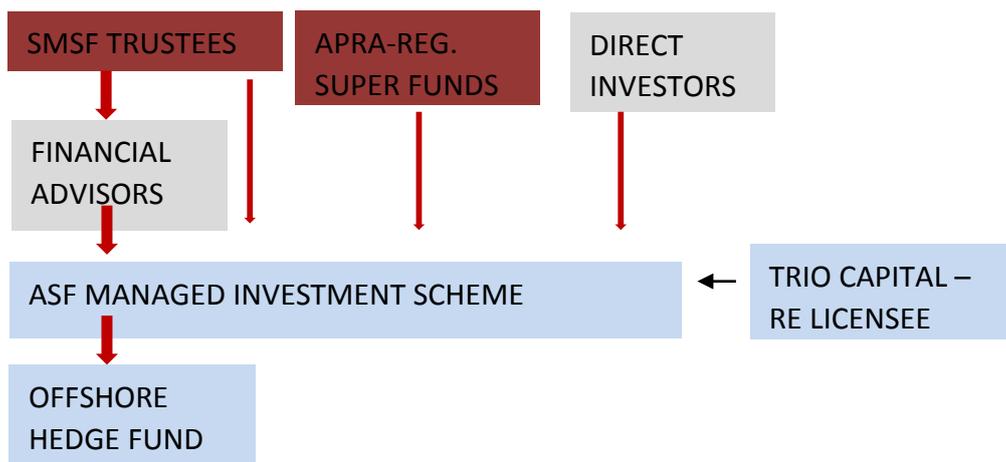
Trio Capital was the responsible superannuation entity (RSE) for four superannuation funds and the responsible entity (RE) for 28 managed investments schemes (MIS). The diagram below (diagram 1) sets out the broad structure of the Trio Capital and illustrates the regulatory framework applying to those entities. Trio Capital attracted investment through direct investors, through APRA-regulated superannuation funds and SMSF trustees (at times acting on the advice of financial advisors). Each of the APRA regulated superannuation funds suffered losses as a result of their exposure to Astarra Strategic Fund (ASF). The ASF was one of 28 MISs operated by Trio Capital.



Of the 28 MISs, the ASF and ARP Growth funds suffered losses:

- The ASF attracted investments from APRA-regulated superannuation funds and SMSF trustees. Estimated losses totalled around \$123 million (initial investment and purported returns).
- The ARP Growth Fund, attracted investment from SMSF trustees and direct investors only. Estimated losses from the ARP Growth Fund are around \$53 million.

DIAGRAM 2: ASF FLOW OF FUNDS



The Astarra Strategic Fund (ASF)

The Astarra Strategic Fund (ASF) was established as a MIS in 2005 with Trio Capital as the responsible entity for the fund. The ASF was marketed and sold as a product designed to produce absolute returns¹ and invested into hedge funds registered in offshore jurisdictions such as the British Virgin Islands (BVI), Cayman Islands and St Lucia — including investments into the Exploration Fund (previously established by Trio in 2004).

This was undertaken through a complicated set of arrangements which involved transactions through deferred purchase agreements (DPAs) with an entity registered in BVI (see diagram 2).

The ASF invested funds on behalf of APRA regulated superannuation funds, SMSFs and other investors. From 2004 to 2009, Australian investors invested around \$84 million in the fund (see table 1). In addition, the ASF had reported \$39 million of returns, so that the total estimated loss to investors was around \$123 million.

The ASF transferred all of the funds entrusted to it to offshore entities. Available evidence indicates that the offshore funds used this money to purchase shares (at an inflated price) in small companies, however, they reported falsified valuations and fictitious returns to Trio Capital.

In their role as managers of the ASF, Trio Capital accepted the falsified valuations and fictitious returns of their investments in the overseas hedge funds without fully investigating the accuracy of those returns. Furthermore, they do not appear to have adequately investigated the risks associated with an investment that appeared to be generating consistently strong returns.

In 2005 APRA identified various governance failings within Trio Capital that were relevant to its management of the four APRA regulated superannuation funds. These included a lack of independent directors. As a result, APRA recommended that Trio Capital restructure its board to

1 Absolute returns refers to strategies employed by hedge funds in order to produce a positive return regardless of the direction and the fluctuations of capital markets, that is, in both rising and falling markets.

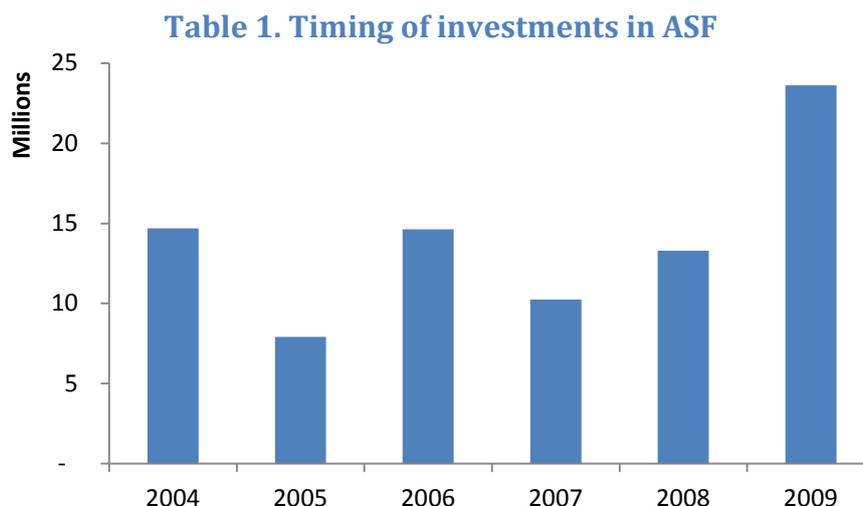
include a majority of independent directors. APRA also recommended that Trio Capital implement a number of other governance related improvements over time. However, it appears that neither the independent directors nor the introduction of other governance improvements that were made as a result of APRA’s intervention, detected that the investments in ASF were not based on accurate valuations and were in fact fraudulent.

ASIC had regulatory oversight of Trio in its role as RE for the ASF MIS. Between 2003 and mid-2009 ASIC investigated Trio or related parties for various minor regulatory breaches. These included matters inadequate disclosure of commissions, Trio’s marketing materials and late lodgement of compliance plan audits. However, all of these were subsequently remedied and did not point to the fraud within any of the funds managed by Trio.

The fraud continued throughout the life of the MIS. In mid-2009 ASIC undertook a review of hedge-funds and identified a hedge-fund involved with the ASF for further investigation. Following a tip-off from a market participant, ASIC believed they had sufficient credible evidence that ASF required more intensive investigation. ASIC communicated this information to APRA in September 2009.

In late September/early October 2009, ASIC and APRA commenced formal investigations and froze the assets of Trio Capital.

The chart below shows the funds invested in the ASF each year.

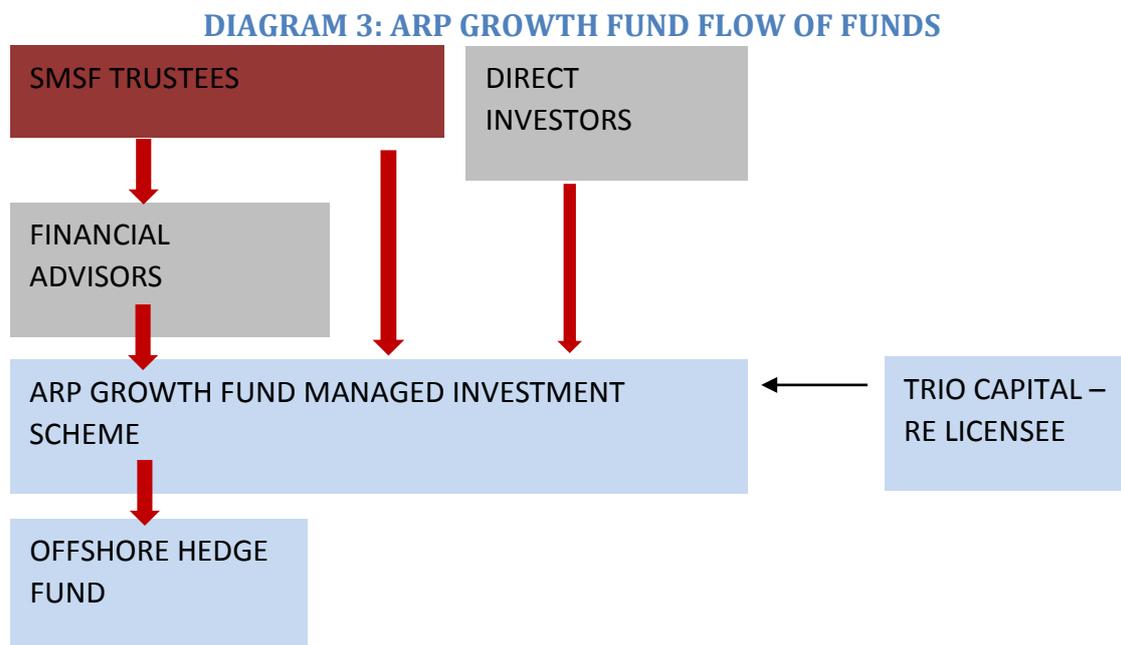


ARP Growth Fund

Prior to 2007 the ARP Growth Fund operated as the Professional Pensions PST. The Professional Pensions PST appointed Trio as trustee in 2004. The Professional Pension PST subsequently became a MIS in 2007. The total amount invested by ARP Growth Fund in the Professional Pensions ARP Limited, an overseas hedge fund, was approximately \$53 million. No APRA regulated funds invested in the ARP Growth Fund.

The ARP Growth Fund attracted investment from SMSFs (as shown in diagram 3). The ARP Growth Fund invested in various offshore funds that in turn invested in a Swap Contract with Bear Stearns, which was lost when Bear Stearns collapsed in the global financial crisis of 2008. Investigations by the liquidators in relation to the value of underlying assets are ongoing.

ASIC was the regulator of the RE licensee (Trio Capital) of the ARP Growth Fund MIS. APRA had no regulatory responsibilities in relation to ARP as no APRA-regulated superannuation funds invested in the MIS.



Investigations into Trio Capital — Regulators' Actions

Introduction

Trio Capital was regulated by both ASIC and APRA. ASIC focused on the AFSL, and the various MISs registered by Trio Capital. APRA prudentially supervised the RSE licensee, focusing on governance and risk management of the licensee rather than their specific investments. The ATO's role in regulating SMSF trustees is primarily through compliance based regulation (see attachment for further information on regulatory responsibilities).

ASIC took regulatory action in relation to Trio Capital within a short period of time once sufficient evidence was available to warrant increased surveillance. Similarly, once sufficient evidence was available, APRA acted quickly to freeze Trio Capital assets.

Action taken by ASIC

ASIC is responsible for licensing and regulating AFSL holders and providing consumer protection in relation to financial services including managed investment schemes. ASIC is an oversight and enforcement body taking a risk based approach to regulation. AFSL holders and other participants are required to comply with the conduct and disclosure obligations in the law. ASIC oversees compliance with these obligations and can take enforcement action when there is non-compliance. ASIC has information gathering powers but its power to take action where there is no evidence of non-compliance is limited.

Hedge fund fraud detection by ASIC uses a mix of risk based filters and market intelligence to select funds for greater scrutiny. For example, from a total of approximately 650 funds (out of around 5000

MISs), around 100 funds were identified in mid-2009 for closer examination. This list included the ASF. Shortly thereafter, a market participant wrote to ASIC in September 2009 warning that his analysis of Trio Capital’s returns looked abnormal and could be a sign of fraud. This additional information combined with ASIC’s own internal analysis, accelerated ASIC’s concerns and in late September 2009 ASIC notified APRA of these concerns.

In early October 2009 ASIC commenced a formal investigation and shortly thereafter placed an ‘interim stop-order’ on the offer, issuance, sale or transfer of interests in the ASF.

Action taken by APRA

From 2005 to 2009, APRA undertook four prudential reviews of Trio Capital. APRA’s prudential reviews of the Trio funds focused on assessing the governance of the funds by the trustees against industry best practice and identified weaknesses and areas for improvement.

In its 2005 prudential review APRA raised a number of governance issues with Trio Capital. APRA raised these issues with the trustees and senior management of the fund and were satisfied that these issues were being addressed.

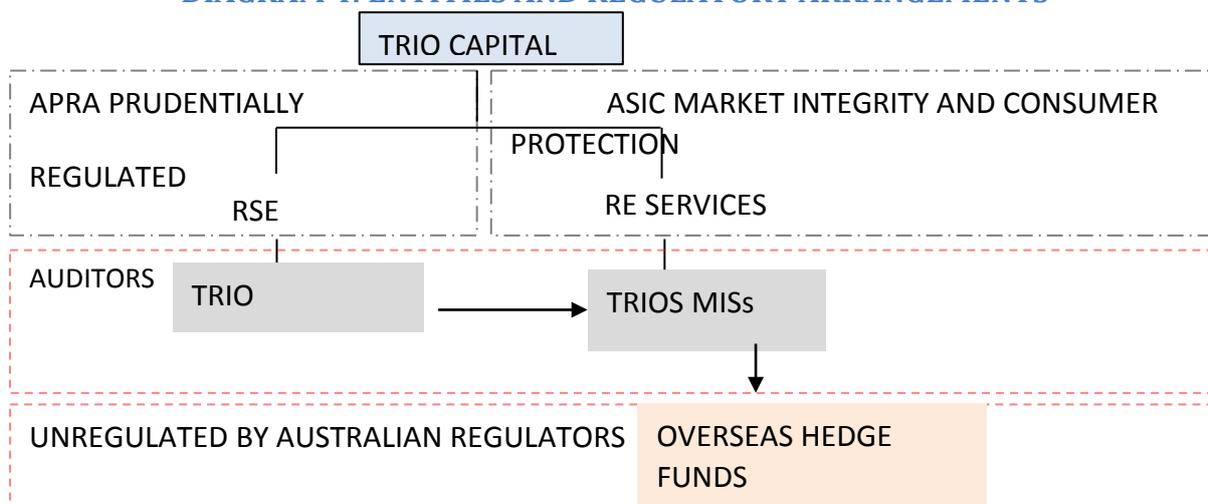
There was no evidence of fraud, and issues raised by APRA regarding related party arrangements appeared to be being addressed and information requested by APRA was being progressively provided. Importantly, none of the independent directors of Trio Capital advised APRA that there were difficulties in obtaining the information requested.

On the basis of what appeared to be poor governance issues, APRA put the fund into an ‘oversight’ category of supervision, which is not unusual for APRA-regulated entities where APRA has raised issues in relation to governance or risk management that need to be addressed.

Throughout the prudential review process, APRA continued to assess the RSE licensee against governance and risk management criteria. However, there was no sign of fraud or theft.

As shown in the diagram below (diagram 4), the fraud was occurring in an offshore unregulated hedge-fund that then provided false valuation to a MIS, which then provided valuation information to the board and senior management of Trio.

DIAGRAM 4: ENTITIES AND REGULATORY ARRANGEMENTS



In late-2008, as part of a prudential review, APRA sought information on the valuation of a number of the fund's investments. In late 2008, APRA received some of the valuations previously requested during this period. The board and senior management attempted to procure the valuations, however, they had difficulty accessing this from the hedge-fund managers.

By mid-2009, APRA started to become more concerned about the valuation of the investments, and the overall performance of the fund. APRA met with the auditors to attempt to address the valuation problem, which did not provide a satisfactory resolution.

In late September 2009, ASIC alerted APRA that they had credible evidence that the ASF was operating with a high-risk hedge-fund. With this information, combined with APRA's growing concerns about Trio Capital, APRA commenced formal investigations and froze Trio's assets in October 2009.

ATO and the Regulation of SMSFs

The ATO does not have a prudential role. The ATO is responsible for regulating SMSF trustees; however, this is a compliance based role. SMSF trustees are responsible for protecting their own interests. The ATO's focus is based on ensuring compliance with the tax and superannuation laws, for example ensuring lodgement of SMSF annual returns and following up on contraventions that are reported by approved auditors.

SMSF trustees are required to appoint an approved auditor to conduct an annual financial and compliance audit of the fund.

Some SMSF trustees suggested to the PJC inquiry that they were not aware that they were actually an SMSF as they took advice from financial planners. These SMSF trustees also said that they were unaware that they would not be entitled to compensation under Part 23 of the SIS Act.

Timing of Regulatory Action

The timing of when to take regulatory action in respect of a financial entity can have a significant bearing on the credibility of the entity and its senior management, the value of the underlying assets, the rate of return on investments and member balances. While APRA and ASIC have a range of powers available to them, those powers need to be balanced against the effective operations of the superannuation system and those entities that they regulate.

If regulators launch a formal investigation without sufficient evidence, there is a risk that this would send a signal to the market that the fund is problematic. An unintended consequence may be that investors lose confidence and the value of any underlying assets may be compromised. In the event that investigations found there was no evidence of wrong-doing, the premature actions of the regulators could result in significant harm to a fully complying fund or MIS, as well as cast doubt on the board and senior management's professional conduct. A severe consequence of this could be a liquidity crisis for the entity and result in significant harm to it.

APRA has a number of funds in 'oversight' rating as part of their prudential supervision. This does not mean that these funds are involved in fraudulent or dishonest conduct; it means that improvements to their operations could be made. In the case of Trio, the 'oversight' rating was assigned due to Trio's poor governance arrangements. Had APRA acted due to these concerns alone, it would have had to act on other superannuation funds in oversight. However for most or all of these there was no evidence of investor funds being inappropriately used. This would have run the risks of causing significant damage to the funds as well as losses to investors.

Conclusion

The Trio Capital fraud represents one of the largest cases of fraud and theft in Australia's superannuation system to date. It has had a significant and detrimental impact on a number of Australian investors, especially those who were ineligible for compensation because they were not members of superannuation funds that were prudentially regulated by APRA.

Certain financial planners and advisers played a critical role in the Trio case, particularly in relation to advising SMSF trustees and non-superannuation investors to invest in Trio Capital. In doing so, it appears that financial planners may not have put member interests first and may not have adequately advised their clients of their responsibilities to manage investment risks when choosing to invest via an SMSF.

A key finding of this review is that APRA and ASIC carried out their roles and responsibilities appropriately. The review also found that the board of Trio Capital failed to manage and monitor risks associated with overseas investments. Another key finding is that some SMSF trustees had an insufficient understanding and knowledge of the risks pertaining to their investments. Inadequate financial advice may have been a contributing factor.

To date, there has been enforcement action taken against a number of individuals associated with the Trio Capital fraud. Importantly, investigations are continuing by the relevant authorities into a number of individuals.

Appendix A — Regulatory Approach for Monitoring Entities

Regulation of the superannuation system spans multiple agencies reflecting the associated risks arising from its compulsory and market linked nature. A key focus of the regulatory framework is to ensure the prudent management of funds and the prudent behaviour of trustees. Regulation of entities is undertaken within a legislative framework which sets out the obligations of trustees and the powers of regulators.

In the case of superannuation, the intensity of regulation is proportional to the risks undertaken by entities and individuals. Given the mandated nature of superannuation and its role in providing retirement income, Government has taken the decision that superannuation should be prudentially regulated. Recognising, however, that some individuals prefer flexibility, the SMSF regime provides individuals with the opportunity to forgo regulation by APRA and to self-manage their superannuation investments. SMSF members are the trustees of their fund and are responsible for the prudent management of the fund. The level of prudential regulation for SMSFs therefore is more akin to self-regulation. Importantly self-regulation is premised on individuals having the capacity to recognise the risks inherent in their investment decisions and or to seek professional assistance in making such decisions.

Table 2. Spectrum of Regulatory Intensity

CATEGORY	APRA REGULATED SUPER FUNDS	MANAGED INVESTMENT SCHEME	SMSF
Responsibility for investment decisions	Trustee	Responsible entity	Members (also trustees)
Prudential regulation (by APRA)	Yes	No*	No
Consumer protection regulation (by ASIC)	Yes	Yes	Yes
Redress and compensation against fraud	Yes through industry levied post funded scheme	May seek redress for misconduct by the AFSL	No compensation scheme for SMSFs. May seek redress for misconduct by the AFSL if it has provided services to the SMSF

*In general, the answer is no however there are a small number of entities that are regulated by both APRA and ASIC.

Overview

The regulation of the superannuation industry is the responsibility of APRA, ASIC and the ATO.

- **APRA** administers the prudential and retirement income provisions of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) and the associated regulations, in respect of the superannuation entities for which it has regulatory responsibility (this does not include SMSFs).
- **ASIC** administers the *Corporations Act 2001* (the Corps Act) and the associated regulations for licensed providers of financial products and services. It is responsible for market integrity and consumer protection across the financial system including some areas of superannuation such as market conduct, disclosure and complaints systems. SMSFs are treated as consumers and are not required to be licensed under the Corps Act.
- **ATO** is responsible for the regulation of SMSFs under the SIS Act. The ATO takes a compliance, rather than prudential, approach to regulation.

APRA's Supervisory Approach

APRA's goal in supervising financial institutions is to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, the financial promises made by supervised institutions are met within a stable, efficient and competitive financial system. APRA's supervisory approach is based on the fundamental premise that the primary responsibility for financial soundness and prudent risk management within an institution rests with its board of directors and senior management.

APRA works constructively with boards and management of the institutions it supervises to resolve prudential issues that may affect the interests of beneficiaries (depositors, policyholders and superannuation fund members). When an institution is unable or unwilling to meet its prudential requirements, APRA engages with these institutions to rectify the outstanding issues and may take enforcement action to protect beneficiaries through a range of remedial actions.

APRA's mandate to supervise the trustees of superannuation funds (excluding SMSFs) derives from the object of the SIS Act. The *Australian Prudential Regulation Authority Act 1998* (the APRA Act), also gives APRA the power to regulate the trustee of a superannuation entity (other than the trustee of an SMSF).

APRA's role is to promote prudent behaviour by trustees of superannuation funds through supervising in the context of a robust prudential framework of legislation and guidance which aims to ensure that risk-taking is conducted within reasonable bounds and that risks are clearly identified and well managed. APRA has a range of supervisory tools including powers to licence trustees, obtain information, to investigate, to give certain directions, to freeze assets and to remove a trustee and appoint an acting trustee.

APRA employs the same risk-based supervision process for superannuation entities that it does for authorised deposit-taking institutions (ADIs) and insurers and aims to complete an intensive review of each fund at least every two years. There are several important differences in the manner in which APRA supervises the superannuation industry compared with ADIs and insurance. These relate to the nature of the financial promise, the lack of capital, the prevalence of outsourcing arrangements, the legislative structure supporting the compulsory contribution system, and the continuing trend towards consolidation of the industry.

In the defined contribution superannuation context, there is no explicit financial promise, only an implicit expectation that the trustee will perform to the best of its ability to meet the expectations of the fund members and beneficiaries. Therefore, governance arrangements and risk management, including investment risk and management of outsourcing arrangements, are essential components of supervisory assessment, while the capital and solvency blocks of the supervision framework are generally out of scope.

The introduction of a prudential standards-making power for superannuation will enable APRA to supervise trustees more efficiently and effectively. Prudential standard-making powers across the other parts of the financial system have been successful in providing APRA with the flexibility to effectively adapt to industry developments and the ability to provide regulated entities with clearer and more tailored legal requirements.

ASIC's Licencing Approach

ASIC performs its regulatory role with regard to superannuation entities and their operations via a number of direct and indirect functions.

Most trustees of superannuation funds in Australia provide financial services and are required to hold an Australian Financial Services (AFS) licence with ASIC for that purpose. ASIC is responsible for the direct regulation of those AFS licensees to ensure compliance with the licence conditions and the obligations imposed on such licensees under the Corps Act. Relevant obligations in this regard include financial product disclosure obligations (such as the preparation and provision of product disclosure statements), ongoing superannuation fund member disclosure (such as member periodic statements and significant event and material change disclosure) and general licensee obligations (such as ensuring those financial services provided under the AFSL are provided efficiently, honestly and fairly).

ASIC is responsible for a number of indirect regulatory functions with regard to superannuation entities. These functions include responsibility for the licensing and regulation of issuers and providers of financial products in which superannuation entities invest (such as the responsible entities of registered MIS) within the jurisdiction and financial services employed by superannuation entities (such as providers of wholesale financial product advice, custody or administration services and non-cash payment facility providers). ASIC also has responsibility for the regulation of the conduct of some gatekeepers to the superannuation entity including providers of retail financial product advice to members of superannuation funds and the auditors of financial reports of some product issuers that superannuation entities may invest in.

The Government's response to the Super System Review into the governance, efficiency, structure and operation of Australia's superannuation system supported the recommendation that ASIC's regulatory responsibilities be expanded to include the registration of SMSF auditors and for ASIC to set competency standards for SMSF auditors. This role will fit within ASIC's priority to regulate the conduct of key gatekeepers to ensure investors and financial consumers have confidence in the financial sector.

ATO's Compliance Approach

The ATO has been the regulator of SMSFs since 1999. The ATO's role is to ensure that SMSFs comply with all relevant provisions in the superannuation laws, including trustee covenants, the investment rules and administrative obligations.

The ATO takes a compliance, rather than prudential, approach to regulation. This is in recognition that members of SMSFs are required to be trustees or directors of the corporate trustee and are responsible for protecting their own interests. The compliance approach taken by the ATO is designed to be effective yet administratively simple by providing assistance and guidance to taxpayers and their advisers. In addition to providing education and support, the ATO has an extensive compliance program largely based on ensuring lodgement of SMSF annual returns and following up on contraventions that are reported by approved auditors.

SMSF trustees are required to formulate and give effect to an appropriate investment strategy, with regard to the risk and return of the fund's investments, expected cash-flow requirements, diversification and liquidity of investments, and the ability to discharge liabilities. They are generally free to invest in a wide range of assets with few restrictions and make decisions in the best interests of members without direction from a third party, provided the investment is permitted under the trust deed, it is in accordance with the fund's investment strategy and does not breach the investment rules (or other provisions) of the superannuation legislation. Investment rules applying to an SMSF include, investments must be on an arm's length basis; lending to members or related parties is prohibited; acquisition of assets from members or related parties is generally prohibited; investments in related parties are limited under the in-house asset rules; and borrowing by the fund or placing a charge over assets is generally prohibited.

SMSFs are required to be audited by an approved auditor on an annual basis to ensure compliance with regulatory requirements and to check financial soundness. Approved auditors play a crucial role in the regulation of the SMSF sector. Approved auditors must provide a report to trustees and report contraventions to the ATO. The ATO undertakes compliance activities to ensure that approved auditors perform their duties to the required standard.

Surveillance Activities — APRA and ASIC

APRA regulates ADIs, insurance firms and superannuation entities. This includes nearly 4265 financial institutions including around 474 superannuation entities (excluding 3,201 small APRA funds). APRA conducts regular prudential reviews of all entities and over a twelve month period visits around and visits 400 entities.

ASIC regulates Australia's financial markets, including securities and investments. This includes 1.9 million companies, of which 21,000 are public companies and 2,200 are listed entities. In addition, investors such as SMSFs could choose to invest in managed investments. There are almost 600 responsible entities, each of which could run many schemes, 230 ASIC regulated superannuation fund trustees and 20 major custodians.

Appendix B — Legislative Framework

Superannuation Industry (Supervision) Act 1993

The SIS Act sets out the legal requirements placed on trustees and directors of registrable superannuation entities. The legislation also sets out the powers available to APRA in respect of licensing, monitoring and investigation of RSE's.

Activity	Requirement	Legislative reference
Licensing	APRA must grant a licence unless APRA has reason to believe that the RSE would fail to comply with RSE law.	29D
Accounting records	An RSE must keep accounting records.	35A
	Each year a trustee must appoint an auditor.	35C
	Trustees must give APRA a copy of audited reports.	36
	Trustees must keep minutes of all meetings for at least 10 years where meetings are about matters affecting the entity. Trustees must keep copies of all member or beneficiary reports for at least 10 years and make them available for inspection by the Regulator.	103, 105
Investments	Investment manager is required to provide a trustee (through an agreement) with information about the making of investments.	102
	A trustee or investment manager must not invest in that capacity unless there is arm's length dealing in a transaction.	109
	Investment Manager cannot appoint a custodian without the consent if the trustee.	122

Activity	Requirement	Legislative reference
Monitoring	APRA has the power to obtain information and it is an offence not to give information.	254
	Trustee is required to produce books relating to the affairs of the entity.	255
	APRA may enter the premises of the trustee.	256
	APRA may seek information from an RSE licensee for information relating to its risk management strategy. If the RSE has a reasonable excuse for failure to comply, breach of this is not an offence.	26HD
	Trustees must notify the Regulator in writing of any occurrence which significantly impacts the financial position of the entity.	106
Appointment	APRA may appoint an individual to carry out investigations of the whole or a specified financial position of the entity.	257
	Trustee is guilty of an offence if they contravene section 257.	262
Investigations	APRA may investigate if it appears that: <ul style="list-style-type: none"> • there is a contravention of the Act; or • the entity's financial position is unsatisfactory. 	263
	APRA has the power to obtain information or freeze assets to preserve the value of member interests.	264
	APRA may remove or suspend a trustee and appoint an acting trustee if the trustee is disqualified.	134

Corporations Act 2001

The Corporations Act sets out the legal requirements placed on responsible entities and holders of AFSL's, directors of registrable superannuation entities (RSEs). The legislation also sets out the powers available to ASIC in respect of licensing, monitoring and investigating of AFSL holders and company directors.

Activity	Requirement	Legislative reference
Licensing	ASIC must grant an AFSL so long as they have no reason to believe the applicant is likely to contravene the licencing obligations. There are a range of general and specific conduct obligations on AFSLs and responsible entities of managed investment schemes.	913B Chapters 7 and 5C
Accounting records	Companies, registered schemes and disclosing entities must keep financial records including financial reports and directors' reports.	285
	Companies, registered schemes and disclosing entities must keep financial records that explain and record its financial position and performance.	286
	Only failure to take all reasonable steps to comply with providing financial records or required reports is a contravention of these obligations.	344
	Financial service licensees must keep financial records that record and explain the financial position of the business.	988A
Director duties	Duty to act with care and diligence.	180
	Duty to act in good faith.	181
	Duty to disclose material personal interests.	191
	Duty not to use their position for an improper purpose.	182
	Duty not to use company information for an improper purpose.	183

Activity	Requirement	Legislative reference
Monitoring	Companies must lodge a notice with ASIC setting out the new division or conversion of shares into different classes.	246F
	A company must record meeting minutes which detail resolutions and proceedings.	251A
	A company must issue a notice to ASIC advising of the issuing of shares.	26HD
	Regarding debentures, a borrower must lodge a notice with ASIC detailing the name of the trustee and debenture information.	283BC
Investigations	ASIC can disqualify a person from managing a corporation.	206F
	ASIC may deregister a company if information on particulars is not returned, if the company has not lodged documents for 18 months or if ASIC believe the company is not carrying on a business.	601AB
	ASIC may deregister a registered scheme in accordance with 601PB.	601PB
	ASIC may issue infringement notices.	1317DAB