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Bulletin

The Trio debacle — "the largest superannuation fraud in Australian history": Part 1

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This is the first part of a two-part article on the collapse of the Trio Group. This part traces the events culminating in the collapse of the Trio Group. Part 2 will survey the enforcement actions taken by ASIC and APRA. APRA's planned enforcement action against former Trio directors has concluded.

Introduction

This article examines the collapse of the Trio Capital Group (Trio Group). The collapse of the Trio Group involved "the largest superannuation fraud in Australian history",[1] with approximately $176 million of Australians' investment funds either lost or missing.

Over 6,000 investors were affected by the collapse of the Trio Group.[2] The Federal Government provided compensation of approximately $55 million to over 5,000 investors who had invested in the Trio Group through APRA-regulated superannuation funds.[3]

The Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) took enforcement action against a number of persons involved with the Trio Group, including current and former directors, auditors and financial advisors. The results of the enforcement actions included two prison sentences, three ASIC-imposed bans from providing financial services, 22 enforceable undertakings, the suspension of one Registrable Superannuation Entity (RSE) licence, and the cancellation or cessation of two Australian financial services licences.

Trio Group structure

The events that eventually led to the collapse of the Trio Group commenced in late 2003 when Wright Global Asset Management Pty Ltd (Wright Global) purchased a funds management business in Albury, New South Wales named Tolhurst Funds Management Pty Ltd.

The directors of Wright Global were Mr Shawn Richard, Mr Matthew Littauer and Mr Cameron Anderson. They also became directors of Tolhurst Funds Management Pty Ltd. Mr Richard subsequently became a central figure in the collapse of the Trio Group.

These directors facilitated a number of company name changes which resulted in Tolhurst Funds Management Pty Ltd being renamed Astarra Funds Management Pty Limited (Astarra Funds Management) and a subsidiary of Astarra Funds Management being renamed Trio Capital Limited (Trio).

Trio held an RSE licence issued by APRA. Trio was the trustee of four APRA-regulated superannuation funds and one pooled superannuation trust (see lower left hand box in Fig 1 below). An RSE licensee's legal obligations include compliance with the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act), observance of minimum standards of fitness and propriety, and maintenance of risk management strategies governing the trustee's operations and risk management plans for each superannuation fund operated by the trustee. The SIS Act is generally administered by APRA.

Trio was also the responsible entity of 28 managed investment schemes (MISs) (see lower right hand box in Fig 1). Certain MISs must be registered under the Corporations Act 2001 (Cth).[4] A responsible entity must operate the MIS and perform the functions conferred on it by the MIS's constitution and the Corporations Act.[5] A responsible entity's legal obligations include acting in the best interests of members of the MIS and acting honestly.[6] A responsible entity is accountable to investors for the management of the MIS's assets.

Figure 1 below shows the Trio Group company structure.

Figure 1: Trio Group Structure[7]

<table>
<tr><td colspan="6">Wright Global Asset Management
(Ultimate Australian Holding Company)</td></tr>
<tr><td colspan="6">Astarra Funds Management (formerly Tolhurst Funds Management)
(Ultimate Holding Company)</td></tr>
<tr><td colspan="6">Trio Capital (formerly Astarra Capital Limited and Tolhurst Capital Limited)
(RSE Licensee and RE)</td></tr>
<tr><td colspan="2">RSE
(Trustee Services)</td><td colspan="2">RE
Services</td><td colspan="2">Investment
Services</td></tr>
<tr><td colspan="3">Provides Trustee Services</td><td colspan="3">Provides Responsible Entity Services</td></tr>
<tr><td colspan="3">Astarra Personal Pension Plan
Astarra Pooled Superannuation Trust
Astarra Superannuation Plan
Employees Federations of NSW Superannuation Plan
My Retirement Plan</td><td colspan="3">Astarra Australian Equities Pool
Astarra Conservative Fund
ARP Growth Fund
Astarra Diversified Fixed Interest Pool
Astarra Cash Pool
Astarra Growth Fund
A&T First 200 Fund
Advantage Diversified Fund
Advantage Fund/Equities/Emerging Markets
Advantage Fund/Fund of Funds
Astarra Australian Covered Call Fund
Astarra Balanced Fund
Astarra Capital Protected Pool
Astarra International Covered Call Fund
Astarra Overseas Equities Pool
Astarra Portfolio Service
Astarra Strategic Fund
Astarra Wholesale Portfolio Service
Astarra Wholesale Property Fund
Millhouse AG Private Equity Fund
MARQ Capital Diversified Direct Property Fund
My Growth Plan
My Income Plan
Regional Land Property Fund
TIC Currency Fund
TIC Currency Wholesale Trust
TIC Diversified Property Fund
TIC Diversified Wholesale Property Trust</td></tr>
</table>

The Astarra Strategic Fund and the ARP Growth Fund

Two of the MISs of which Trio was the responsible entity were the Astarra Strategic Fund (ASF) and the ARP Growth Fund (ARP).

In early 2010, investigations by PPB Advisory (the liquidator of Trio) identified that the ASF and the ARP had significant exposure to assets which had the following characteristics: the existence of the assets was unable to be determined; the assets were difficult to value; and the assets were not able to be realised in the short term.[8]

The ASF was being used fraudulently[9] and there were "serious questions about the legitimacy"[10] of the ARP.

The majority of the other MISs of which Trio was the responsible entity were legitimate and provided appropriate returns to investors.[11]

The funds invested in the ASF and the ARP came from superannuation entities of which Trio was the trustee, as well as from other investors such as those who invested through a self managed superannuation fund (SMSF) on the advice of a financial planner.

Astarra Strategic Fund (ASF)

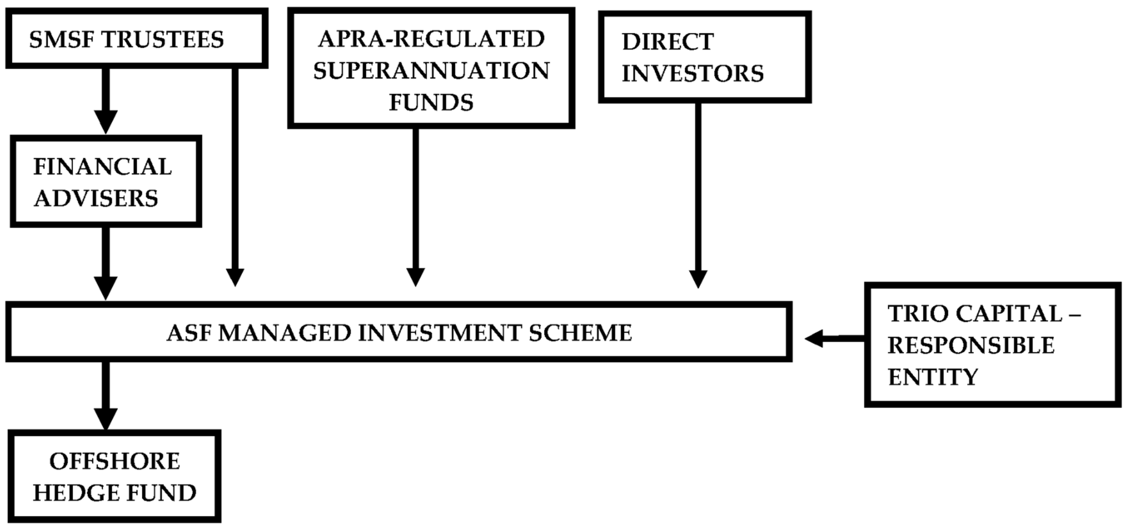
The ASF was an MIS which had been registered with ASIC in 2005.[12] It was established as an Australian-based hedge "fund of funds".[13] As at April 2010 (the time the ASF was wound up), it had a notional value of approximately $123 million and more than 6,000 members.[14] Investors included those investing through APRA-regulated superannuation funds and SMSFs, and direct investors. The investment manager of the ASF was Astarra Asset Management Pty Limited (Astarra Asset Management).

The structure of the investments made by the ASF was as follows:

- investors would pay money to Trio as the responsible entity;[15]
- Trio would then deposit the funds into its custodian account. The custodian was initially ANZ Custodian Services, but was subsequently changed to National Australia Trustees Limited;[16]
- the custodian would then deposit the invested funds into a Hong Kong bank account of EMA International Limited (EMA).[17] The purpose of EMA was to facilitate investments by the ASF, through Astarra Asset Management as its investment manager, into overseas hedge funds through a "deferred purchase agreement";[18]
- the deferred purchase agreement allowed EMA to receive certain "delivery assets" in the future with the value of those assets to be determined by the performance of five underlying off-shore hedge funds (underlying funds).[19] The underlying funds were registered or administered by companies in jurisdictions such as the British Virgin Islands, Anguilla, St Lucia, the Cayman Islands, Belize, the Cook Islands and Nevis;[20]
- the ASF purportedly invested the funds it received into the underlying funds.[21] The underlying funds purportedly used the funds to purchase shares (at an inflated price) in small companies;[22] and
- under the deferred purchase agreement, the funds were intended to be held offshore until Astarra Asset Management requested the delivery of those investments.[23] It was intended that Astarra Asset Management would then transfer the assets to Trio.[24]

Figure 2 below shows a summary of the flow of funds from investors into the ASF.

Figure 2: Flow of funds into the ASF[25]



In April 2010, the ASF, the ARP and three other MISs operated by Trio were wound up by order of the Supreme Court of NSW.[26] By this time, Trio was in voluntary administration. Justice Palmer commented on the ASF's investment structure in the following terms:

> A large proportion of the Scheme funds has not been used to acquire readily identifiable assets located in easily accessible jurisdictions. Rather, the funds have been invested in purchasing from an entity whose substance is impossible to ascertain an unsecured promise to deliver assets … Anyone even slightly acquainted with the commercial world knows that if one wants to conduct financial operations as far away as possible from the scrutiny of tax authorities, investment regulatory authorities and investors themselves — in short, if one wants to conduct financial operations dishonestly or illegally — then it is to these jurisdictions that one goes to incorporate puppet companies with puppet directors in order to operate fraudulent schemes and to move money around the world in secrecy.[27]

Before the court, the administrators of Trio, PPB Advisory, had strongly suggested that EMA's investment into the underlying funds was "a fraudulent scam".[28] By way of example, PPB Advisory noted that one of the underlying funds, Atlantis Capital Markets Cayman LDC, a fund apparently domiciled in the Cayman Islands, had been struck off the Cayman Islands register of companies as at 31 December 2003 (which was well before EMA purportedly invested in it).[29]

Executing the ASF fraud — the roles of Mr Jack Flader and Mr Shawn Richard

The ultimate controller of the Trio Group fraud was Mr Jack Flader. Mr Shawn Richard was a central figure in Australia.[30]

Mr Richard was, at various times, a director and the responsible officer and agent of Trio. He was also a director of Trio's immediate holding company, Astarra Funds Management.[31]

The investment manager of the ASF, via agreements with Trio, was Astarra Asset Management. Mr Richard was a director of Astarra Asset Management. Astarra Asset Management was an authorised representative of Trio and Wright Global Investments Pty Ltd (Wright Global Investments). Mr Richard was a director and the responsible officer of Wright Global Investments.[32]

EMA was a "special purpose vehicle" established to facilitate investments by the ASF in funds offshore. Mr Richard controlled EMA.[33]

Mr Richard represented himself to investors as being the controller of Trio, Wright Global Investments and Astarra Funds Management. However, those representations were false. At all times after July 2004, Mr Flader, a US citizen based in Hong Kong, was the ultimate controller of those entities and the business of the Trio Group.[34]

Mr Richard used his positions with respect to Trio, Wright Global Investments and Astarra Funds Management to arrange the transfer of Australian investors' funds from MISs operated by Trio in Australia (such as the ASF) (Trio managed funds), to overseas funds controlled by Mr Flader (Flader controlled funds). The money was subsequently used to purchase shares in US companies at inflated prices, from foreign companies controlled by Mr Flader (Flader vendor companies). The inflated share prices realised significant profits for the Flader vendor companies.[35]

The shares which were purchased were themselves only quoted on the Over-the-Counter Bulletin Board as unregulated US equity securities. This meant that they were vulnerable to share price manipulation, and often there was only restricted stock available for trading.[36]

From November 2006, when the directors of Trio became concerned and decided to cease Trio's exposure to a particular Flader controlled fund, Mr Richard participated in the creation of new offshore funds for Trio to invest in, all of which were controlled by Mr Flader. He falsely represented to Trio and ASF investors that he was diversifying the portfolio to different investment managers from the original Flader controlled funds.[37]

Global Consultants and Services Limited (Global Consultants and Services), of which Mr Flader was the Chief Executive Officer and Chairman, was the custodian of the assets of the Flader controlled funds at all material times. Global Consultants and Services also provided administration services to EMA.[38]

The only moneys invested in the Flader controlled funds were those from the Trio managed funds, with two exceptions. The Australasian Conference Association Superannuation Trust and the Australian Baseball Federation Inc invested directly in one of the Flader controlled funds.[39]

A large proportion of profits received by the Flader vendor companies, from the sale of shares purchased from Australian investors' moneys deposited into the Flader controlled funds, were subsequently used to provide funds to Trio, Wright Global Investments, Astarra Funds Management and Astarra Asset Management, by way of loans from other companies controlled by Mr Flader. Mr Richard falsely represented to auditors of Trio, Wright Global Investments, Astarra Funds Management and Astarra Asset Management that he controlled these funding companies.[40]

In the criminal proceedings against Mr Richard, his counsel said, in relation to these arrangements:

> … an adequate description of that scheme was that it was a scheme designed to divert Australian investors' money from superannuation and managed investment funds into overseas hedge funds contrary to the interest of the investors.[41]

In response to a question from the Parliamentary Joint Committee on Corporations and Financial Services (which conducted an inquiry into the collapse of the Trio

Group) (Parliamentary Joint Committee) regarding whether the Flader controlled funds were fraudulent, PPB Advisory said that they were.[42]

In the proceedings for the winding-up of the ASF, Justice Palmer said:

> What Trio told investors about ASF's investment strategy in the Product Disclosure Statements in August and September 2009 was nothing more than gibberish.[43]

ARP

The ARP had been registered in July 2007.[44] PST Management Pty Ltd, which was owned and controlled by Mr Tony Maher (previously known as Mr Paul Gresham), was the investment manager for the ARP. Investors in the ARP included investors through SMSFs and direct investors, but not trustees of APRA-regulated superannuation funds.

The structure of the investments made by the ARP was as follows:

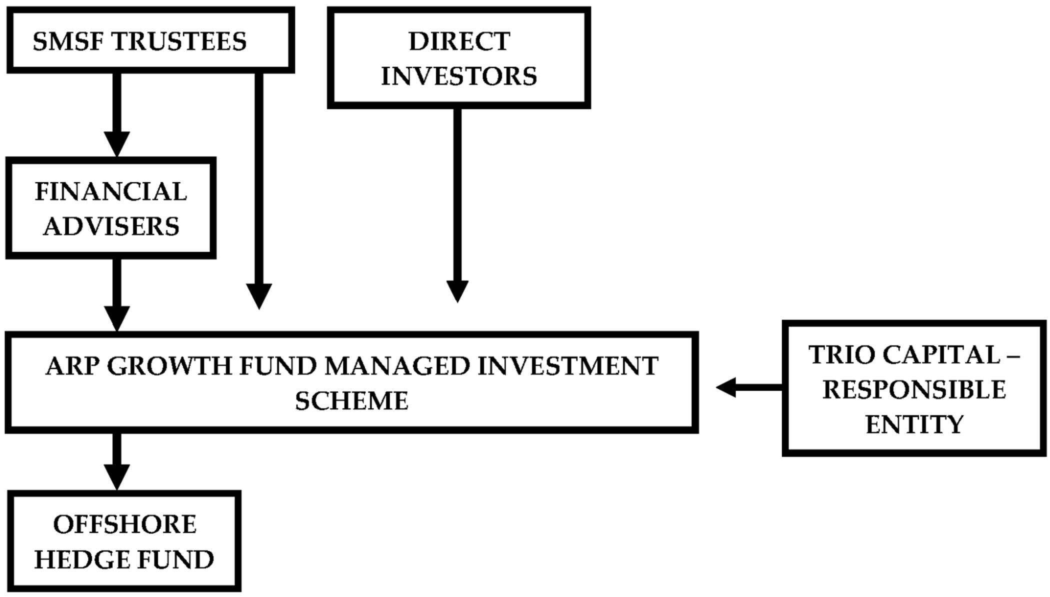
(a) the ARP would purchase units in Professional Pensions ARP Limited, a special purpose company registered in the British Virgin Islands (Professional Pensions ARP);[45]

(b) Professional Pensions ARP would then purchase shares in certain portfolios of Empyreal SPC Limited (Empyreal), which was licensed as a professional fund in the British Virgin Islands;[46] and

(c) Empyreal would then negotiate a "swap agreement" between its investment portfolios named Archimedes Segregated Portfolio and Pythagoras Segregated Portfolio with Bear Stearns, which at the relevant time was a global New York based investment bank.[47]

Figure 3 below shows a summary of the flow of funds from investors into the ARP.

Figure 3: Flow of funds into the ARP[48]



The key underlying assets of the ARP were the swap agreements between Archimedes Segregated Portfolio, Pythagoras Segregated Portfolio and Bear Stearns.[49] In mid-2008, Bear Stearns collapsed as part of the global financial crisis. JP Morgan, who acquired Bear Stearns, took over Bear Stearns' obligations under the swap agreements.[50]

As mentioned above, in April 2010, the ARP was wound up by order of the Supreme Court of NSW.[51] At that time, Professional Pensions ARP was about to be placed into liquidation.[52] The ARP's investment in Professional Pensions ARP represented, directly or indirectly, the majority of assets of the ARP.[53] Justice Palmer found that the majority of the assets held by the ARP appeared to be wholly or partly irrecoverable.[54]

The ARP "fraud"

According to APRA, it was the collapse of Bear Stearns which caused the loss of the funds invested in the ARP on the basis that the value of the swap agreement fell to zero.[55] In APRA's view, the funds were lost as a result of a bad investment decision rather than fraud.[56]

The Parliamentary Joint Committee was not satisfied that APRA was correct in assuming that the swap agreement did exist and that its value was zero due to the collapse of Bear Stearns. The Parliamentary Joint Committee was concerned that the alternative possibility — that there was never a swap agreement and ARP was a fraudulent venture — had not been fully investigated by APRA.[57]

To date, PPB Advisory (the liquidator of Trio) has not been able to determine that the underlying assets held by the ARP were non-existent.[58] According to ASIC, ASIC will continue its investigation and PPB Advisory intends to release reports relating to the ARP which will provide further information about what happened to investors' funds.[59]

The tip-off — Mr John Hempton writes to ASIC

Mr John Hempton was the Chief Investment Officer of Bronte Capital, an Australian-based global fund manager. He had extensive experience in the funds management industry and prior to Bronte Capital was involved with Platinum Asset Management. He authored a blog which discussed his views on certain investment activities around the world.

After a tip-off from a reader of his blog, Mr Hempton, through his own investigation, had concerns with Astarra Asset Management (at that time called Absolute Alpha) which was the investment manager for the ASF.[60] He noticed that under the management of Astarra Asset Management, the ASF was achieving suspiciously smooth returns during the global financial crisis.[61] He was immediately concerned with his findings in relation to Astarra Asset Management and the ASF, and said on his blog:

> I looked — and within forty minutes I became very concerned — but could not prove harm to the fund's investors.[62]

In September 2009, Mr Hempton wrote to the then Chairman of ASIC, Mr Anthony D'Aloisio, expressing his concerns about the ASF and Astarra Asset Management.

Mr Hempton's letter prompted ASIC to commence an investigation into the conduct of the Trio Group.

As described in his blog, Mr Hempton considered that his investigations were relatively straightforward. He wrote:

> There was no genius in my letter — everything could be found (fairly easily) on the internet — and the original tip-off came from a reader of my blog — who noticed links with a story I wrote up in March 2009.[63]

Regulatory action — ASIC

In October 2009, ASIC commenced an investigation into the Trio Group. Its investigations began in relation to suspected breaches by the directors of entities in the Trio Group of certain provisions of the Corporations Act.[64] This was followed by ASIC issuing an interim Product Disclosure Statement stop order on Trio preventing offers, issues, transfers or sales of interests in the ASF and certain other MISs of which Trio was the responsible entity.[65] A further interim stop order was issued in relation to superannuation funds of which Trio was the trustee.[66]

ASIC then pursued current and former Trio directors and financial planners who provided advice to those who invested in entities managed by the Trio Group. The penalties obtained by ASIC ranged from prison sentences to enforceable undertakings. A summary of the penalties achieved by ASIC to date are set out in the Annexure at Tables 1 and 3. ASIC obtained or effected two prison sentences, three bans from providing financial services, nine enforceable undertakings, and the cancellation or cessation of two Australian financial services licences.

In the Supreme Court of NSW, Garling J accepted that Mr Flader was "the architect and ultimate controller of the scheme".[67] ASIC, in connection with the Australian Federal Police and overseas regulatory counterparts, had sought to collate evidence against Mr Flader to establish that he had breached Australian law. However, despite those investigations, ASIC has determined that there is insufficient evidence to prove that Mr Flader breached Australian law and has now finalised its investigation into Mr Flader.[68] Notwithstanding that the Parliamentary Joint Committee and Supreme Court of NSW determined that Mr Flader was the mastermind of the fraud,[69] there have been no criminal charges or civil actions brought against Mr Flader.

Regulatory action — APRA

Between 2004 and 2009, APRA conducted several prudential reviews of Trio.[70]

In October 2008, Trio was not able to provide APRA with information regarding the valuation of certain Trio funds.[71]

In October 2009, APRA issued directions which froze the assets of the four superannuation funds of which Trio was the trustee.[72] The freezing orders precluded the superannuation funds from accepting contributions and rollovers, making benefit payments or transfers to other funds, or allowing investment switching.[73]

In December 2009, APRA issued Trio with a show cause notice seeking an explanation of why Trio should not be suspended or removed as trustee of the four superannuation funds and one pooled superannuation trust of which it was trustee.[74]

Later that month, APRA suspended Trio's RSE licence, as there had been numerous breaches of the conditions on the licence. This meant that Trio could no longer act as trustee of the superannuation entities. APRA appointed ACT Super Management Pty Ltd as acting trustee of the superannuation entities.[75]

APRA then initiated an investigation into the conduct of officers of Trio. This eventually resulted in APRA obtaining enforceable undertakings from 13 former directors of Trio. Table 2 in the Annexure sets out a summary of the enforceable undertakings obtained by APRA.

The enforceable undertakings accepted by APRA effectively removed those individuals from operating in the superannuation industry for the ban period.

In October 2013, APRA concluded its planned enforcement action in relation to former Trio directors.[76]

The MISs are wound up

On 16 December 2009, Trio was placed into external administration by its directors.[77] PPB Advisory was appointed as the administrators of Trio and from that date took control of Trio.[78]

As mentioned above, in April 2010, in the Supreme Court of NSW Justice Palmer ordered that five MISs of which Trio was the responsible entity, including the ASF and the ARP, be wound up.[79]

In June 2010, PPB Advisory became the liquidator of Trio after it was placed into liquidation by resolution of creditors.[80]

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Footnotes

1. Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital* (PJC Report), May 2012, at [9.1].
2. Above, n 1, at [2.12].
3. The Hon Bill Shorten, Assistant Treasurer and Minister for Financial Services and Superannuation, Media Release "Financial Assistance to Trio's Superannuation Fund Investors", 13 April 2011.
4. Corporations Act 2001 (Cth), ss 601EB and 601ED.
5. Above, n 4, s 601FB.
6. Above, n 4, s 601FC.
7. Above, n 1, Figure 2.1.
8. PPB Advisory, *Report to creditors pursuant to s 439A of the Corporations Act 2001, Trio Capital Limited*, 8 April 2010, pp 21–2.
9. Above, n 1, at [2.5].
10. Above, n 1, at [2.5].
11. Above, n 1, at [2.8].
12. Above, n 1, at Table 2.2.
13. Above, n 1, at [2.9].
14. Above, n 1, at [2.12].
15. Above, n 1, at [2.28].
16. Above, n 1, at [2.28].
17. Above, n 1, at [2.29].
18. Above, n 1, at [2.29].
19. Above, n 1, at [2.30].
20. *Trio Capital Ltd (Admin App) v ACT Superannuation Management Pty Ltd* [2010] NSWSC 286; BC201002268 at [22].
21. Above, n 20, at [35].
22. Treasury, *Review of the Trio Capital fraud and assessment of the regulatory framework*, 2013 (Treasury Review of Trio Capital Fraud), 26 April 2013, p 10.
23. Above, n 1, at [2.29].
24. Above, n 1, at [2.29].
25. Based on Treasury Review of Trio Capital Fraud, Diagram 2.
26. Above, n 20, at [51].
27. Above, n 20, at [22].
28. Above, n 20, at [36].
29. Above, n 20, at [36].
30. *R v Richard* [2011] NSWSC 866; BC201106219 at [65].
31. Above, n 1, at [2.32].
32. Above, n 1, at [2.32].
33. Above, n 1, at [2.32].
34. Above, n 1, at [2.32].
35. Above, n 1, at [2.32].
36. Above, n 1, at [2.32].
37. Above, n 1, at [2.32].
38. Above, n 1, at [2.32].
39. Above, n 1, at [2.32].
40. Above, n 1, at [2.32].
41. Above, n 30, at [60].
42. Above, n 1, at [2.34].
43. Above, n 20, at [26].
44. Above, n 1, Table 2.2.
45. Above, n 1, at [2.25].
46. Above, n 1, at [2.23].
47. Above, n 1, at [2.23].
48. Based on Treasury Review of Trio Capital Fraud, Diagram 3.

49. Above, n 1, at [8.5].
50. Above, n 1, at [2.25].
51. Above, n 20, at [51].
52. Above, n 20, at [49].
53. Above, n 20, at [49].
54. Above, n 20, at [48].
55. Above, n 1, at [8.6].
56. Above, n 1, at [8.6].
57. Above, n 1, at [8.10].
58. Above, n 1, at [8.8].
59. Australian Securities and Investments Commission 2015, *Trio and Astarra*, accessed 11 February 2015, www.asic.gov.au.
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65. Trio Capital Limited, Significant Event Notice dated 6 November 2009.
66. Trio Capital Limited, Significant Event Notice dated 11 November 2009.
67. Above, n 30, at [63].
68. Australian Securities and Investments Commission 2015, *13-294MR Update on Trio investigation*, accessed 12 February 2015, www.asic.gov.au.
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70. Above, n 1, at [2.59].
71. Above, n 1, Table 2.2.
72. Australian Prudential Regulation Authority 2015, *APRA appoints acting trustee to superannuation funds operated by Trio Funds Limited; ASIC takes licensing action against Trio Capital Limited*, accessed 17 February 2015, www.apra.gov.au.
73. Above, n 72.
74. Above, n 1, at [2.60].
75. ACT Super Management Pty Limited, Significant Event Notice dated 17 December 2009.
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78. ACT Super Management Pty Limited, Significant Event Notice dated 17 December 2009.
79. Above, n 20, at [51].
80. Above, n 1, Table 2.2.