



**SuperGuard 360**  
a RAINMAKER INFORMATION Service



# AT WHAT PRICE

*The hidden cost of financial fraud for SMSFs*

SG 360 Position Paper N° 02 | January 2018

## Sources of data and information

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The information used in this white paper is sourced from official and industry research reports and explanatory material produced by a wide range of highly regarded government agencies and private sector organisations, including the Australian Bureau of Statistics, the Australian Crimes Commission, the Australian Institute of Criminology, the Australian Prudential Regulation Authority, the Australian Securities and Investments Commission, the Australian Taxation Office, the Financial Ombudsman Service, the Financial Services Council, Investment Trends, the Rainmaker Information, the Small Independent Super Funds Association, the SMSF Association (formerly known as SPAA, the SMSF Professional Association of Australia), the Superannuation Complaints Tribunal, the Senate Economics references Committee reports Australasian Accounting, Business and Finance Journal and KPMG.



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# *Introduction*

## *Summary of main points*

**T**he true cost to self managed superannuation funds (SMSF) of financial fraud and mismanagement is more than triple the amount reported, according to Rainmaker Information. Once all the associated costs and loss of potential earnings are taken into account, SMSFs lost around \$103 billion over the past 10 years to financial schemes and products that were poorly or fraudulently managed.

Further, that does not take into account the emotional and physical toll caused by serious financial loss.

This figure is much higher than previous estimates because the cost of fraud has two elements: the fraud itself, and the cost of lost earnings due to that amount being taken out of the market and no longer achieving investment earnings. SMSFs are particularly vulnerable to such events as they do not have the same protection and avenues of compensation as traditional super funds that operate under the Australian Prudential Regulatory Authority (APRA).

This paper looks at some of the cases where SMSFs and other investors have fallen prey to investment fraud and misconduct. These case studies highlight some of the traps that SMSFs should look out for when making investment decisions, and lessons learnt from these cases. In addition, we highlight some of the tried and tested principles of investment management and red flags that may indicate signs of potential trouble.



## The pros and cons of SMSFs

SMSFs have many advantages; the key ones being control over your own investments, the ability for family members to pool their assets to grow them for retirement, and the flexibility of being able to invest in a wide range of assets. With these advantages come the risks and responsibilities of being a trustee of your own fund.

Trustees have specific responsibilities under superannuation legislation and also under the trust deed. They must invest the fund's investments in accordance with its investment strategy. Failure to do this means a trustee can end up paying significant penalties.

But the biggest risk for SMSFs is ensuring that investment decisions are prudent and based on well-backed advice. If things do go wrong with investments SMSFs do not have the same protection or access to compensation as traditional superannuation funds. This is because SMSFs members are also trustees of their fund so are not regulated by the Australian Prudential Regulation Authority (APRA). This can make them particularly vulnerable to financial misconduct and fraud.

When considering investments, SMSFs can minimise the risks by being aware of some of the signs of poor financial advice or investment products that need further investigation.

## The real cost to SMSFs of financial fraud and mismanagement

The real cost of financial fraud and mismanagement to SMSFs over the past decade is more than triple the reported losses once all the associated costs and loss of potential earnings are taken into account, according to the Rainmaker Information. Over the 10 years to 30 June 2017, reported lost funds from SMSFs due to financial mismanagement and fraud amounted to \$30 billion. Once fines, frozen funds and the opportunity cost are taken into account Rainmaker calculates the loss to escalate to \$103 billion, made up of \$30 billion in lost funds, \$1 billion in fines, \$25 billion in frozen funds and \$47 billion in the opportunity cost of foregone earnings. See Figure 1.

The opportunity cost, or the amount that could have been earned on the lost funds, is based on the average super fund return in Australia over the 10-year period. This is just the financial cost; when the emotional, social and health tolls are factored in, the cost goes far beyond these calculations.

With around \$677 billion in assets, the self-managed superannuation fund sector represents 30 per cent of the \$2.2 trillion Australian superannuation sector. It is the largest superannuation sector and yet it is also the most vulnerable to financial mismanagement and fraud, with SMSFs losing billions of dollars to scams and poor management, and with none of the protection available to traditional APRA-regulated super funds.

The number of cases of financial scams and mismanagement over the past decade is significant, as can be seen in Figure 2 on page 8. Some of these cases involve Australia's largest financial institutions.

Some notorious failed financial schemes where SMSFs and other investors suffered substantial losses include Storm Financial, Westpoint, Opes Prime, Trio/Astarra, and Sonray Capital. Other schemes that have caused significant losses include agricultural investment schemes such as Timbercorp, Great Southern, Willmott Forests Ltd and Gunns Plantation Ltd.

## Fraud on the rise

Fraud is prevalent across society. The Australian Bureau of Statistics (ABS) estimated that 1.6 million Australians were the victims of personal fraud in 2014-15, or almost 9 per cent of the adult population, and three quarters of these cases experienced direct financial loss. The total estimated loss for 2014-15 was a whopping \$3 billion. This is likely to be underestimated given the

feelings of embarrassment for people who have been 'scammed' and the cumbersome process required to report it to authorities. Many people who are victims of fraud may not realise this until well after the event, by which time it is too late to remedy.

Both cyber-crime and identity theft are very real and present dangers to all members in society, as we live in an increasingly interconnected and complex world. The ABS estimated that the number of incidences of identity theft in the 2014-15 were 0.7 per cent of adults, which varied according to age, relationship status, and educational background.

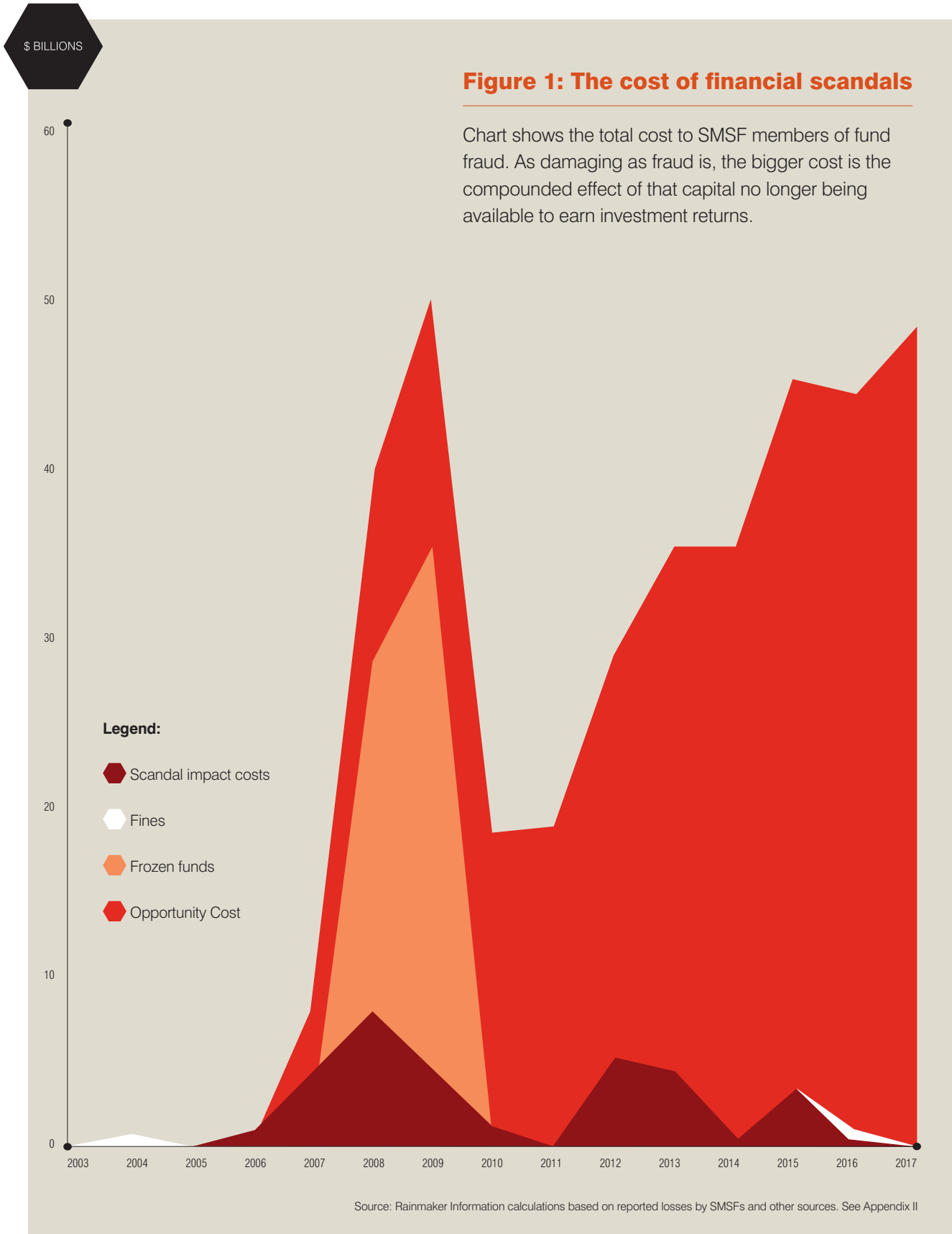
Research by KPMG in 2016 revealed fraudulent crime within the Australian superannuation industry increased by around 27 per cent between September 2015 and March 2016 compared to the previous six months. The amount of money lost to this crime increased by a massive 200 per cent.

These figures are particularly concerning for SMSFs given they do not have the same protection as traditional super funds. Oversight of the SMSF system falls largely under the Australia Taxation Offices (ATO) remit, along with the Australian Securities Investments Commission (ASIC). The ATO is a large and complex organisation. Further, ASIC's performance was recently reviewed by Commonwealth Treasury as part of the (Murray) Financial System Inquiry. The score card for ASIC in 2016 left much to be desired, which is why it was followed up with additional public funding to improve ASIC's future regulatory performance.

In reality, ASIC has a huge responsibility across a wide landscape, and has limited resources at its disposal. While Australia's financial regulators are widely considered to be world-class in their oversight of financial markets, they have limited resources in undertaking complete surveillance in order to prosecute and remedy financial scandals.

Ultimately, SMSF trustees are exposed to risk factors beyond the traditional volatilities experienced over the business cycle. Spreading fund assets over different asset classes and across many individual exposures will not completely insulate the fund from potential losses. Investors also face risks that cannot be forecast or diversified away as a result of erroneous or negligent due diligence, outright fraud, malfeasance, theft, and misleading and/or deceptive conduct. These are circumstances that cannot be eradicated from the investment management process.

But trustees can become aware of the risks and take precautions. Lessons can be learnt from past cases of fraud and mismanagement. These are useful for identifying signs of poor financial advice or investment products that need further. The following case studies represent some of these lessons:



# Case studies and lessons learnt

## Commonwealth Bank's financial planning scandal

### Lesson learnt: Beware of high pressure sales tactics offering unrealistically high returns

In 2014 the confidence of the public in Australia's major financial institutions was shaken when fraud and misconduct was discovered in the financial planning division of one of Australia's top four banks.

After a number of serious cases of misconduct, Commonwealth Bank's financial planning division, Commonwealth Financial Planning Limited (CFPL), was revealed to contain elements of a sales culture that encouraged some of its financial planners to mislead, and in some cases defraud their clients.

In one case, CBA customers Merv and Robyn Blanch lost \$260,000 of their retirement savings as a result of the conduct of one of the bank's leading financial planners. The planner, Don Nguyen, invested the money into high risk investments despite their instructions to the contrary. After an extended legal battle the Blanches settled out of court with the bank for \$95,000. Throughout the legal battle CBA protected Nguyen and denied any wrongdoing.

Another of Nguyen's clients, Jan Braund and her husband Alan, who was in the early stages of dementia when they sought advice on financial planning, had trusted their life savings of \$1 million to Don Nguyen. The financial planner invested the Braunds' money in high-risk CBA products, earning himself a high commission by doing so. By 2009 the Braunds' money had been halved and Alan Braund's dementia had taken hold.

Despite receiving a letter from CBA financial planner and whistleblower, Jeff Morris, outlining corruption and misconduct within the bank and pointing out that innocent people were losing their life savings, corporate regulator ASIC took no action against CBA.

In 2014 Jeff Morris, Jan Braund and several other of the bank's clients appeared at a Senate Inquiry into ASIC's handling of the Commonwealth Bank's financial planning scandal.

As a result of the inquiry, eight CBA planners were banned from the industry by ASIC but the regulator was also slammed for failing to investigate the tip offs provided by Jeff Morris in 2008. Senate Economics References Committee chairman Senator Mark Bishop said in a media release "the evidence the committee has received is so shocking and the credibility of both ASIC and the CBA so compromised that a royal commission really is warranted."

Senator Bishop said the way in which "vulnerable trusting

people were targeted shows that the CFPL planner involved had a callous disregard for their clients' interests."

The report from the inquiry said its confidence in ASIC's ability to monitor CBA's implementation of its undertaking to overhaul its systems and culture and new compensation process as "severely undermined", and pointed to instances of "fabricated documents and forged signatures" as well as offers of compensation that were "manifestly inadequate."

## Collapse of Trio Capital Group

### Lesson learnt: Avoid overly complicated investment structures that you don't understand

The collapse of the Trio Group involved "the largest superannuation fraud in Australian history", with approximately \$176 million of Australians' investment funds either lost or missing. The Albury-based wealth manager illegally transferred hundreds of millions of dollars of client funds offshore from where it disappeared.

More than 6,000 investors were affected, with the Federal Government providing compensation of around \$55 million to over 5,000 investors who had invested in the Trio Group through APRA-regulated superannuation funds. The rest, many of them SMSFs, were largely left without compensation with the government determining that they were not covered under the provisions of the Superannuation Industry (Supervision) Act, or SIS.

The events that eventually led to the collapse of the Trio Group started in late 2003 when Wright Global Asset Management Pty Ltd (Wright Global) purchased a funds management business in Albury NSW named Tolhurst Funds Management Pty Ltd. The directors of Wright Global were Shawn Richard, Matthew Littauer and Cameron Anderson. They also became directors of Tolhurst Funds Management Pty Ltd. Richard subsequently became a central figure in the collapse of the Trio Group.

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

The decision not to compensate SMSFs in the same way as APRA-regulated super funds was heavily criticised at the time, as was ASIC's failure to act soon enough or pursue the Trio fraudsters. SMSF investors in Trio were limited to pursuing compensation

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**Figure 2: Notable financial scandals involving Australian financial service firms**

YEAR	LICENSEE NAME	ESTIMATED NUMBER	ISSUES INVOLVED	RESOLUTION
1993-2007	<b>Storm Financial</b>	Investors: <b>3,000 - 4,000</b> Total amount involved: <b>\$3 billion</b>	Inappropriate advice encouraging clients to make highly geared investments.	\$400 million (approx.) settlement with 1,500 clients.
2004-2006	<b>Westpoint</b>	Investors: <b>3,524</b> Total amount involved: \$388 million	New investor money used to service existing investments. Planners encouraged clients to make bad investment and promoters kicked back commissions to planners in return.	\$160-\$170 million recovered for investors. CFO convicted and put on a 18 months good behaviour bond.
2003-2008	<b>Opes Prime</b>	Investors: <b>600</b> Total amount involved: <b>\$631 million</b>	Investors advised to buy geared share portfolios and assign beneficial ownership of their holdings to Opes. Opes lent on behalf of ANZ and Merrill Lynch and took ownership of the scrip provided as collateral. Opes then lent that stock for a fee to short sellers, along with stock provided by institutional investors for a fee. Clients thought they owned shares; they ended up losing their investment.	Settlement of \$253 million and return of around 40 cents in the dollar to creditors and investors. ANZ has agreed to improve compliance in various areas including reconciliation, compliance processes and risk management. Two directors jailed.
November 2005 and September 2009	<b>Trio/ Astarra</b>	Investors: <b>6,000</b> Total amount involved: <b>\$180 million</b>	Trio was the trustee of 4 superannuation funds and directed most assets into hedge funds located in the Caribbean. There is little evidence that the purported investments were actually made. Most of the money invested was lost.	11 advisors jailed, banned, disqualified from managing companies or agreed to remove themselves from the industry for a total of more than 50 years.

**Figure 2: Notable financial scandals involving Australian financial service firms**

YEAR	LICENSEE NAME	ESTIMATED NUMBER	ISSUES INVOLVED	RESOLUTION
2003-2010	<b>Sonray Capital</b>	Investors: <b>3,000 retail clients</b> Total amount involved: <b>\$46 million</b>	Theft, fraud and false accounting.	Investors received two thirds of their money back. Founder sentenced to six and a half years in prison.
2006-2010	<b>CBA</b>	Total amount involved: <b>up to \$300 million</b>	Key findings of the senate inquiry include: <ul style="list-style-type: none"> <li>• Unethical and dishonest conduct and breach of duties by a number of advisers working at CFPL.</li> <li>• CBA's compliance regime failed allowing unscrupulous advisers to continue operating.</li> </ul>	1,100 investors received \$52 million in compensation and CBA agreed to enforceable undertakings imposed by ASIC.
2003-2013	<b>ANZ</b>	N/A	ANZ Prime Access wealth package gave customers priority access to financial planners, investment.	8,500 customers compensated \$30 million in total and two advisors dismissed.

through their financial advisor's professional indemnity insurance.

John Telford, a Wollongong-based investor who suffered substantial financial losses, told the Inquiry that the light sentence received by Mr Shawn Richard was inadequate given the significant financial and emotional toll on investors. He pointed out that had ASIC shown its own findings to the court, this would have illustrated the harm Richard's fraudulent crime caused. This included findings from an ASIC study into the social impacts on investors who were not compensated for significant loss after the failure of managed investment schemes, or because of inappropriate financial advice collapse:

"It [ASIC] found some investors suffered 'catastrophic loss', which meant 'their life will never be the same.' Some felt prolonged anger, uncertainty, worry and depression. Several lost their homes and many had been seriously ill since the loss. Many went without food on occasion and avoided heating or cooling their home. Those who were ashamed to tell others of their plight had isolated themselves from friends and family, and the impact had created long lasting marital strain."

## The Storm Financial scandal

### **Lesson learnt: Avoid complex investment structures with high debt**

The collapse of Storm Financial was catastrophic for many retirees and SMSFs and is an example of an overly complex structure based on high debt levels for investors. Storm Financial was a major financial planning network in Australia, with 115 staff, \$4.5 billion of funds under management and 14,000 clients at the time of its collapse. It was formed on 23 May 1994, although it had existed in other incarnations prior to that. The founders of Storm Financial were Mr and Mrs Cassimatis, who were also directors and joint chief executive officers.

Storm Financial convinced many of its clients to acquire significant debt to fund investments in the stock market. The Storm Financial model was allegedly a one-size-fits-all approach, with the majority of clients given similar advice regardless of their personal circumstances or needs.

Typically these investors, who included retirees or people intending to retire in the near future, were encouraged to take out loans against the equity in their homes in order to generate a lump sum to invest in the share market. Clients were generally then advised to take out margin loans to increase the size of their investment portfolio.

Margin loans were organised with a loan-to-value ratio (LVR) of around 80 per cent, with a buffer of 10 per cent. This was higher than the industry standard. The LVR determines the amount of the loan compared to the underlying collateral. Margin loans were relatively unregulated at the time and were not subject to regulation by ASIC. The global financial crisis and decline in the share market during September to December 2008 triggered numerous 'margin calls' (this is when notice is given to the borrower that either further collateral needs to be supplied, or the securities purchased with the loan need to be sold to return the loan to equilibrium). Many investors could not raise the necessary funds with the result that the backing or collateral for the loans, including the family home, were lost or placed at risk.

Storm Financial was placed into voluntary administration under part 5.3A of the Corporations Act 2001 on 8 January 2009. Its bankers appointed receivers to take control of most of its assets on 15 January 2009. On 26 March 2009, the Federal Court of Australia ordered that Storm Financial be wound up. As a result, Storm Financial had no funds for compensation and attention turned to the banks that had provided Storm Financial clients with loans.

The ramifications of the collapse of Storm Financial was summarised by the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Financial Products and Services report as follows:

"The committee acknowledges the catastrophic effect that the collapse of Storm Financial has had on many investors, particularly those double-gearred clients who were not afforded an opportunity to respond to margin calls; fell into negative equity; and were sold out of their portfolios in late 2008, at or near the bottom of the market. These investors now face great challenges in meeting living expenses, repaying debts and, in some cases, keeping their homes."

## Agribusiness schemes

### **Lesson learnt: Be wary of highly leveraged schemes that rely upon complex tax structures**

The collapse of agribusiness managed investment schemes (MIS) in timber, fruit and other projects in 2008 and 2009 saw a large number of individual investors, some through SMSFs, lose millions of dollars. In 2009 two of Australia's largest agribusiness schemes failed – Timbercorp and Great Southern – followed by others, including Willmott Forests Ltd and Gunns Plantation Ltd.

An agribusiness MIS allows small investors to pool their funds to invest in a large-scale agricultural operation. They were

introduced to Australian investors after the introduction of the Managed Investments Act 1998, ostensibly to encourage agricultural diversification after the decline of the local forestry industry.

These schemes were promoted as tax effective investments and also encouraged investors to take on high debt levels to fund investments, commonly up to 90 per cent of the value of their investment. They were structured so that investors were described as operating the investment in their own right, allowing them generous tax deductions. Investors were assured that cash flow from the harvest would pay off the loan and eventually produce a secure income stream.

For small investors caught up in the schemes, the attraction was often less about the tax advantages and more about supporting local industry and agricultural ventures. Many had very modest incomes and lost not only their initial investment and prospects of future income, but were also burdened with repaying loans they took out to fund their venture.

A report by the Senate Economics References Committee on the collapse of the industry described the severe impact on these investors, saying the evidence before the committee was riddled with stories of the “shattered lives of people who invested in agribusiness MIS – separations, broken relationships, lost life savings, bankruptcy, ruined health, depression, self-harm and families placed under enormous stress.”

The failure of the financial advisers, along with regulator ASIC, to be brought to account over these losses impacted heavily on small investors.

Many investors told the Senate Committee they did not fully comprehend the loan arrangements and assumed the loan was held against the actual investment with liability limited to the trees or plants. In fact the loans were ‘full recourse’ and borrowers were personally liable for the debt.

What these failed schemes highlight is the poor advice given to investors who were following the recommendations of advisers they trusted to be professional. Some advisers were found to be completely deficient in their knowledge of the investment and the basic principle of matching a client’s risk profile and income to a product. The Senate Committee report describes this:

“Evidence indicates that, in some cases, advisers disregarded their clients’ risk profiles; withheld important information, particularly about the speculative nature of the venture; failed to provide critical documents; willfully downplayed risks; and exaggerated the promised returns.”

In essence the onus is on investors to be vigilant regarding any recommended investment. As the saying goes, if it sounds too good to be true, it usually is.

## Guvera tech wreck

### **Lesson learnt: Insist your accountant or adviser discloses the incentives they are receiving to place you into any scheme or product they recommend**

Another failed scheme, start-up music streaming company Guvera, employed an unusual money-gathering technique. It raised money through networks of accountants who recommended unlisted Guvera stock to SMSF clients who qualified as “sophisticated investors.”

Guvera raised \$185 million from around 3,000 “sophisticated investors,” mostly SMSFs. It released a prospectus mid-June 2016 to raise up to \$100 million as part of a planned initial public offering in July 2016. A successful listing could value the company, which last financial year reported a loss of \$81.1 million from revenue of \$1.2 million, at more than \$1.3 billion. Luckily it wasn’t allowed to list.

What wasn’t publicised to the investor was the unusual relationship Guvera had with AMMA Private Equity, of which Darren Herft was the sole director. Guvera had outsourced financing to AMMA, which was paid to raise money and host fundraising events where investors would meet Herft’s tech experts.

Accountants and advisers who directed clients toward an investment in Guvera received share options in the business as well as generous incentives.

“We got introduced through our accountants as a high-risk investment,” says Diane Lucas, who runs a bookkeeping business with her husband. “It sounded great. They made lots of promises and didn’t deliver.”

Herft was very effective at raising capital. From 2009 to 2016 AMMA raised \$185.3 million on behalf of Guvera – an extraordinary amount for an unlisted Australian technology company. AMMA was paid \$22.5 million for the fundraising, a commission rate of 12 per cent.

Many Guvera shareholders had patiently waited for a stock exchange listing for years. It was their way to cash out. After years of waiting for their pay, most gave up.

The figures speak for themselves – \$1.2 million in revenue on an \$81.1 million loss and a failed attempt to raise money from sizeable seed investors. There are many sources of venture and angel capital funds for good start-up companies with potential so when an idea has good prospects it will receive support. At such an early stage in its life, a start-up technology company should not be seeking a listing on the ASX as it has not proved itself.

A responsible financial adviser should not recommend an IPO like Guvera's to the average SMSF investor, let alone 3,000 of them. It appears that the main fundraiser for this IPO was promoted via related accounting firms. It is possible some SMSFs were set up just to invest in this IPO as their only asset.

This type of investment or venture is a highly speculative investment suitable for no more than 1 to 5 per cent of the most aggressive of investors' portfolios. It should never have been promoted through accounting firms or financial planning firms to their SMSF clients.

## Banksia Financial Group

### Lesson learnt: Beware of promises of unrealistically high returns

The \$660 million collapse of Banksia Group was another lesson in one of the simplest rules of investment – unrealistically high expected rewards. The other is that there is a vast gulf between heavily regulated banks and unlisted, unrated institutions that set themselves up to operate and appear like banks.

Banksia's business model was not dissimilar to that of a bank. It borrowed money from the public by issuing debentures and then lent the funds to the public by financing residential and commercial mortgages.

But it was not a bank. Banks are regulated by the Australian Prudential Regulation Authority (APRA) and must hold a minimum level of equity capital to protect against bad loans. Most banks must hold \$10 of capital for every \$100 of loans written. Banksia held less than \$3.60 for every \$100 of loans, so it did not take many bad loans to cause the structure to collapse.

Banksia offered investment products, including fixed-term, superannuation and pensioner deeming accounts and mortgage schemes. It promoted itself as a non-bank alternative and had a network of 14 branches across Victoria, NSW and SA with headquarters in Melbourne.

The failure of Banksia Securities and the others illustrates that investors need to be aware of the risks of what they are investing in.

Other similar failed debenture schemes include:

- Angus Securities (mortgage fund) (\$220 million – 2015).
- Gippsland Secured Investments (\$143 million – 2013).
- Provident Capital (\$176 million – 2012).
- Australian Capital Reserve (\$300 million – 2007).

## Charterhill Group

### Lesson learnt: A one-stop shop for advice, investment products and loans may have conflicts of interest

The collapse of the Charterhill Group, an accountancy firm that specialised in property investment through self-managed super funds, saw 160 investors and SMSFs lose around \$11.5 million.

Charterhill offered a one-stop shop consisting of a property research centre, a property sourcing company, a property development company, an SMSF formation and administration service, and a loan originating service sourcing finance for SMSFs.

This type of vertical integration in a financial services business is one that has been used to maximum advantage by the major banks. Unfortunately this type of business model often maximises the profits of the financial group to the detriment of investors.

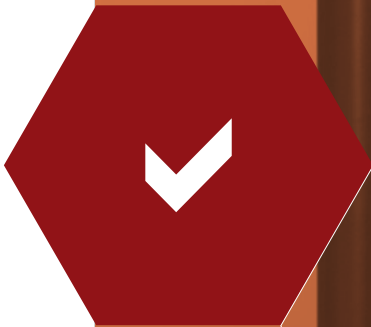
Conflict of interest is hard to avoid when the same organisation advises clients where to invest, assists in providing loans to invest and also develops and manages the investments.

Director of Charterhill Group, George John Nowak, was charged with misappropriating \$1.8 million in SMSF property investments.

The Charterhill Group collapse was not surprising. What was surprising is that the regulators, ASIC and ATO, did not take action against the group earlier.

Similar cases include:

- **WPS Group** – another failed property investment group (Disqualified director – Craig Gore).
- **Active-Super (Royale Capital)** – linked to Craig Gore – charged with fraud and owing more than \$4 million to SMSF investors.
- **Charterwell Enterprises** – collapsed and charged with fraud and owing more than \$60 million to investors.
- **Burdett Buckridge & Young (BBY)** – collapsed and owing \$16 million to clients.



# Protect your investment

## What can SMSFs do to protect themselves?

First and foremost, SMSF trustees need to understand they are ultimately responsible for the investment decisions of their super fund. Advisers are just that – they offer advice and can make investment recommendations – but SMSF trustees are required by law to responsibly invest for their fund in accordance with its investment strategy. Trustees must manage the risks associated with any investment, guard against fraudulent behaviour and be vigilant about monitoring investments.

## Investment fraud strategy

SMSF trustees need to invest in assets that have a good chance of maintaining and growing their real value and delivering adequate retirement incomes for members. In doing so, they should abide by tried and tested rules of investment management, such as:

- **Diversify:** Don't hold all your eggs in one basket – genuine diversification reduces investment and fraud risk.
- **Ask questions:** If something sounds too good to be true, it probably is.
- **Research:** investigate all investments and understand them thoroughly before investing.
- **Understand your investments:** Know what you own and why you own it.
- **Know your service providers:** Check the credentials of your service providers, their corporate structures and where they are licensed.
- **Don't spread yourself thin:** Wide diversification is only required when investors do not understand what they are doing.
- **Long term vision:** Invest for the long term, not for short term profits.

## Look for red flags before investing

There are a number of key signs to look for before investing in any financial product or scheme:

- **Guarantees:** No one can guarantee an investment's performance. All investments carry risk.
- **Unregistered products:** Investment scams often involve unlicensed individuals selling unregistered products. Before investing, you should ensure that the distributor and product

are licenced and that key information provided can be independently verified.

- **Overly consistent returns:** Any investment that consistently increases in value month after month or provides remarkably steady returns, regardless of market conditions, should raise concerns.
- **Complex investments or strategies:** Investment professionals should be able to clearly explain how they invest and the risks associated with the investment. If you do not fully understand the proposed investment, do not invest.
- **Custody of assets:** Assets should always be held by a reputable custodian, rather than by the investment manager.
- **Missing documentation:** If someone tries to sell you a financial product with inadequate documentation do not invest. There should be a prospectus or offer document with any reputable investment product or scheme.
- **Account discrepancies:** Unauthorised trades, missing funds and other anomalies in your account statements need to be investigated and explained immediately.
- **Sales pressure:** If you are being pressured into making a quick investment decision, do not invest until you are completely comfortable with the decision.

## Monitoring investments

Once the investment decision has been made, SMSFs should not be complacent but should continually monitor their investments for signs of potential trouble. If your investment is not performing as it should, or as you were advised it would, request information from your financial adviser or the investment manager. If you believe there are discrepancies it is important to take action early before your investment has been seriously impacted.

Because SMSF trustees are responsible for making all investment decisions and ensuring that there is sufficient cash liquidity to make benefit payments when required, their activities are considered to be conducted 'entirely at the risk of the beneficiaries.' SMSFs do not enjoy the same level of protection from fraud and misconduct as other super funds, which have access to the protection and compensation mechanisms provided (APRA). The ATO is responsible for regulating over 600,000 SMSFs, in addition to administering Australia's taxation system.

As the selected case studies illustrate, SMSFs are particularly vulnerable to financial fraud and misconduct. Keeping a close watch on your investments is vital to seeing signs of trouble and taking action early.



## Who can help?

SMSF trustees can appeal in a number of ways to the authorities if they think they are the victims of financial fraud or misconduct.

These include:

- Lodging a complaint directly with the service provider.
- Lodging a formal complaint through industry complaint agencies, professional associations or industry regulators.
- Pursuing the matter through the courts or reporting it to the police.
- Lodging a complaint with the Financial Ombudsman Service (FOS).

Given the complexities of SMSF financial and legal arrangements, navigating this process may be complex for trustees unused to dealing with these types of matters and they may benefit from consulting an external adviser.

## Seven ways SuperGuard 360 can help

SuperGuard 360 is a service provided by Professional Standards Mutual, a Corporate Authorised Representative of Rainmaker Information, to help protect SMSF trustees and members from a number of the risks they face.

Protection provided by SuperGuard 360 includes:

- 1. Prevention:** SuperGuard 360's experienced, independent research team utilises its technical, superannuation and investment expertise and Rainmaker intelligence and data tools to monitor industry developments and flag potential issues with service providers and investment offerings. For example, one way to avoid investing in schemes run by previous scammers is to check the SuperGuard360 website to see if the directors are on the list of disqualified directors or banned advisers, or have been involved in any previous cases.
- 2. Access to information:** Our regular newsletter, SuperNews, draws on the deep knowledge base of the Rainmaker Group to provide the industry insights that SMSF trustees need to take control of their fund. We keep readers up to date with changes in superannuation legislation and industry trends as and when they occur, so you're never in the dark about your super.
- 3. Independent professional opinion:** If your fund becomes a victim of fraudulent, dishonest or misleading and deceptive conduct, we will help you understand and assess your legal position, rights and options. We provide clients with access to a technical support helpline, technical and legal professionals and mediation through industry channels.

### 4. Access to legal support for opinion and mediation:

We work with a network of legal practitioners who will provide you with a formal opinion on your situation and help you proceed to mediation and litigation if necessary.

### 5. Administrative support for your case:

When you are a victim of fraudulent, dishonest or misleading and deceptive conduct, managing huge volumes of paperwork can be a significant challenge. We help alleviate this burden by acting as a central repository for all paperwork and administrative issues associated with your case.

### 6. Possible litigation funding:

Many victims of fraudulent, dishonest or misleading and deceptive conduct do not seek restitution because the costs of doing so can be very high and the probability of success can be low. We have access to litigation funders who will assess whether they would be willing to help fund your case and, if so, the terms under which they would do so. In some instances, we may consider funding your case ourselves.

### 7. Discretionary compensation:

Is available to SuperGuard 360 registered funds at the absolute discretion of Rainmaker Information.

SuperGuard 360's tax-deductible subscription for this service is A\$695 for funds with up to A\$1 million in assets and A\$995 for funds with over A\$1 million in assets.

The subscription ensures that you have access to high quality, up to date industry, technical and legal expertise when you need it.

# Conclusion

SMSFs have many advantages for investors, such as control over investments and flexibility. With these advantages come risks, including the risk of becoming the target of financial misconduct or fraud.

The real cost of financial fraud and mismanagement to Australian SMSFs over the past decade is enormous – \$103 billion. This is triple the reported losses, once all the associated costs and loss of potential earnings are taken into account. The emotional and social cost is beyond calculation.

But it is possible to learn lessons from past mistakes. The best way to protect yourself and your SMSF from fraudsters and financial mismanagement is to be vigilant about investment choices and to monitor existing investments.

Investment safety checklist for SMSFs:

- Do your research so you understand what you are investing in.
- Look for the red flags that could indicate potential trouble with an investment – services such as SuperGuard 360 can help with this.
- Make sure an investment matches your fund's investment strategy.
- Seek independent advice to help you make decisions.
- Once invested monitor your investments regularly for signs of trouble.
- Act quickly if you believe there is a problem with your investment.

## Footnotes

- <sup>1</sup> APRA statistics as at March 2016.
- <sup>2</sup> Global Pension Assets Study 2016, Willis Towers Watson.
- <sup>3</sup> ATO Superannuation statistics.
- <sup>4</sup> Dynamics of the Australian Superannuation System. The Next 20 Years: 2015 to 2035; Deloitte November 2015.
- <sup>5</sup> Submission by the SMSF Association of Australia in 2014 to the Financial System Inquiry.
- <sup>6</sup> SMSF Insights, FSC/UBS SMSF Report, December 2015.
- <sup>7</sup> Rainmaker analysis of SMSF statistics published by the ATO, May 2016.
- <sup>8</sup> Highlights from the Investment Trends 2015 Self-Managed Super Fund Survey, Investment Trends, 2015.
- <sup>9</sup> Self Managed Super Fund Report, 2015. Vanguard Investments Australia and Investment Trends.
- <sup>10</sup> Personal Fraud 2014-15, ABS catalogue number 4528.0.
- <sup>11</sup> Targeting Scams: Report of the ACC on scams in 2015; ACC May 2016.
- <sup>12</sup> Speech by Matthew Bambrick, ATO Assistant Commissioner, Superannuation, to the 5th Annual 2013 Small Independent Super Funds Association (SISFA) SMSF Forum, 17 October 2013, 'Issues affecting SMSFs: the ATO perspective'.
- <sup>13</sup> Serious and Organised Investment Fraud in Australia; ACC & AIC joint report 2012.

**AT WHAT PRICE: The hidden cost of financial fraud for SMSFs**

SG 360 Position Paper N° 02 | January 2018



# Appendix I

## Timeline of government financial reforms in Australia

Several financial inquiries outlined below have failed to tackle growing concentration in Australian finance sector or the need to separate general banking from investment banking as the reform process in the United State, UK and Europe is contemplating.

The recently announced royal commission into banking is also underpinned by ongoing reports of misconduct within the banks, summarised in a timeline below.

Government response	9 October 2016	Revised life insurance remuneration reform regulations
Financial Advice	6 April 2016	Former ANZ planner jailed for stealing almost \$1 million
Banking	5 April 2016	Westpac subsidiary paid penalties of \$493,000 after breaching consumer protections
Trading	5 April 2016	ASIC sued Westpac over alleged market manipulation in setting bank bill swap rate
Banking	4 April 2016	ANZ announces it reported three breaches of dispute resolution requirements
Banking	30 March 2016	ANZ announced it would refund \$5 million
Financial Advice	17 March 2016	ASIC imposed conditions on Macquarie financial services licensee
Financial Advice	15 March 2016	ANZ pays \$4.5 million compensation for breaches
Banking	7 March 2016	ASIC found ANZ breached responsible lending laws
Insurance	7 March 2016	CommInsure chief medical officer blows the whistle on unethical practices
Trading	4 March 2016	ASIC sued ANZ for alleged market manipulation in setting bank bills swap rate
Financial Advice	3 March 2016	ASIC banned former NAB adviser for misleading and deceptive conduct

Financial Advice	16 February 2016	ASIC banned a former director of a Macquarie subsidiary for breach of duties
Financial Advice	4 February 2016	ASIC banned former NAB adviser for forging client signatures
Trading	4 February 2016	CBA staff accused of complicity in Ponzi scheme worth \$76 million
Financial Advice	2 February 2016	Commonwealth bank offers \$3 million compensation for financial advice to date
Banking	20 January 2016	Westpac paid \$1 million fine over credit limit practices
Trading	15 January 2016	Two dismissed ANZ traders claim culture of sex, drugs and alcohol
Banking	18 December 2015	ASIC permanently banned former WA breach bank manager
Trading	10 December 2015	Macquarie Securities paid \$110,000 penalty over market integrity rules
Banking	25 November 2015	Commonwealth Bank to refund \$80 million after failing to apply benefits
Banking	12 November 2015	ANZ provides \$13 million compensation after failing to pay bonus interest
Insurance	29 October 2015	Westpac offered refunds over unneeded insurance cover
Banking	19 October 2015	CBA to refund \$7.6 million due to failure to waive fees

# Appendix II

## References to financial loss case studies

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