Review of the Regulatory Framework for Managed Investment Schemes – Consultation Process

Submission by

Sterling First Action Group

September 2023

Table of Contents

About Us

The Sterling First Action Group initially began as a Facebook group, following the collapse of the Sterling Group of entities in May 2019. The group was originally intended to be a place where all victims of the Sterling Group collapse could exchange views, discuss how the collapse had impacted them, and to share information. The group is managed/administrated by a committee of volunteers who have been affected, be it directly or indirectly (i.e., family members acting on behalf of elderly parents).

It has been almost 4½ years since the collapse, and the Sterling First Action Group has continued to support all victims. This has included assistance with preparation of AFCA complaints and proof of debt lodgements with insolvency administrators; lobbying local, state, and federal MPs; submission of questions to be raised at the PJC on Corporations & Financial Services; and raising awareness through the media.

We have also lodged a variety of submissions, including to the:

- February 2023; Senate Economics Legislation Committee – Australian Securities and Investments Commission Investigation and Enforcement,
- October 2022; Senate Economics Legislation Committee – Financial Sector Reform Bill 2022 [Provisions] and related bills,
- December 2021; Senate Economics Legislation Committee – Financial Accountability Regime Bill 2021 [Provisions] and related bills,
- November 2021; Senate Inquiry – Sterling Income Trust (also appeared as witnesses at this inquiry),
- August 2021; Treasury – Compensation Scheme of Last Resort, and
- March 2021; Treasury – Australian Financial Complaints Authority.

In each submission we referenced the operation of the Sterling Income Trust (the managed investment scheme) and have provided details of the devastating impact it has had on the lives of those caught up in the collapse. We have repeatedly highlighted the glaring deficiencies in both the regulatory and compensatory environments in which the Sterling Income Trust operated, and we hope that our experience can provide some guidance on improving the environment in which managed investment schemes operate in Australia.

Affiliations

Over the past three years we have taken part in various campaigns by consumer advocacy group, CHOICE, calling on the Federal Government to establish the Compensation Scheme of Last Resort (CSLR) as a top priority. Since that time, we have been in regular contact and have contributed a variety of materials to their media campaigns.

We have continued to work closely with Senator Louise Pratt, who has repeatedly raised concerns about the Sterling Group and its subsidiaries during Senate proceedings and had used her time to question ASIC in the PJC on Corporations & Financial Services on many occasions.

Our Response & Recommendations

We thank the Treasury for the invitation to provide a submission to the Inquiry and give permission for our submission to be made public. We must emphasise that we do not purport to have any specialised professional, legal or other specialised knowledge in this area. What we can bring to the table is over four years of experience in dealing with the aftermath of a failed managed investment scheme (**MIS**) that, in many respects, is atypical of MIS in general. Many Sterling Group investors were not only unaware of the true nature of what they were getting themselves into, but also were deliberately misled as to the operation of the MIS, so the comment we provide is purely from the perspective of the Sterling Group experience and may not necessarily extrapolate to other MIS.

To assist the Treasury with context to some of our answers, we have created a summarised timeline of the events leading up to the collapse of the Sterling Group. This can be found in *Appendix 1 – Sterling Group Chronology*. In preparation for this submission, we also conducted a short online survey of victims who suffered financial losses associated with the collapse of the Sterling Group. The survey was designed to show their experience during the 'sales pitch' point of the investment process, and their understanding of the Sterling Group's managed investment scheme. This data will be referenced throughout our submission, with a full copy of the survey results available in *Appendix 2 – Victim Survey*.

In responding to the issued raised and questions for consideration in the Consultation Paper, we have decided to focus on key areas we believe have most impacted victims of the Sterling Group collapse. As such, our submission will concentrate only on the questions to which we can provide our experience. Our response to the Consultation Paper, along with a summary of our recommendations, is provided below.

List of Recommendations

RECOMMENDATION 1

The client must be provided with the definitions of the categories that designate a wholesale client and must provide written consent attesting to the fact that they understand the conditions under which they are to be considered a wholesale investor.

RECOMMENDATION 2

ASIC to be given greater discretion in the MIS registration process, including the ability to review, approve and refuse the officers of the proposed MIS. Where the officers of the proposed MIS have a history of bankruptcy, company insolvency, deregistration for non-compliance issues, or have been officers of other previously failed MIS, they should be closely scrutinised.

RECOMMENDATION 3

ASIC to be given greater discretion to refuse an application to register a MIS by amending s601EB(1) of the Corporation Act to 'ASIC may register the scheme' (rather than 'ASIC must'), and include an additional clause that states 'unless there is any other reason which in ASIC's reasonable opinion justifies the refusal of the application'.

RECOMMENDATION 4

In the event an authorised representative is appointed by an AFS licensee, the AFS licensee obligations (i.e., fit and proper person assessment, risk management systems, etc.), and the obligations of the responsible entity (i.e., acting honestly, exercising care and diligence, acting in the best interest of investors, compliance requirements, etc.), should flow down to the authorised representative.

RECOMMENDATION 5

ASIC's public warning power to be extended to include situations where ASIC has reasonable grounds to suspect a financial product or credit product (or a class of such products) has resulted, will result or is likely to result in significant consumer detriment.

RECOMMENDATION 6

ASIC to require all AFS licensees to submit their PII policy details as part of their annual compliance requirements to ensure the terms of cover remain adequate for the purposes of the Corporations Act.

RECOMMENDATION 7

Current and prospective members of AFCA must provide a copy of their current PII policy to be deemed eligible for an AFCA membership. Regulatory changes should also be implemented giving ASIC the power to enforce AFCA requests for information.

RECOMMENDATION 8

The Government work with state and territory governments to clarify the jurisdictional overlap between Commonwealth and state regulation of financial products. In particular, to review investment schemes that include real property rights, including accommodation, leases and tenancy rights under state and territory laws.

RECOMMENDATION 9

The Government review the marketing of, and financial advice for, investment products which deal in real property interests and whether or not sufficient protections are available for investors in these products.

Chapter 1. Wholesale client thresholds

Q4(a). If consent requirements were to be introduced, how could these be designed to ensure investors understand the consequences of being considered a wholesale client?

Q4(b). If consent requirements were to be introduced, should the same consent requirements be introduced for each wholesale client test (or revised in the case of the sophisticated investor test) in Chapter 7 of the Corporations Act? If not, why not?

The issue of client consent and sophisticated investor acknowledgement for Sterling Group victims did not become apparent until after the collapse of the Sterling Group in May 2019. In December 2017, the Sterling Group started fundraising under the name of SilverLink, with SilverLink Securities and the SilverLink Investment Company registered as new entities of the Sterling Group. There was no product disclosure statement, and although it was not a registered managed investment scheme, ASIC suspected[1] criminal conduct, and that the Sterling Group had actively concealed their fundraising through SilverLink companies.

They did this via the sale of redeemable preference shares in the two entities in exchange for a Sterling New Life Lease (**SNLL**, a rent-for-life scheme). In fact, the Information Memorandum (**IM**) clearly stated that *'an investment in the Redeemable Preference Shares is only available to SNL [Sterling New Life] Tenants'.* However, the IM disclaimer specified that the investment offer was only available to potential investors who qualified as either or both a sophisticated and/or a professional investor or invest under the small offering provisions of the Corporations Act.

Considering that SilverLink was specifically targeted at retired persons who, in the majority of cases, had little prior investment experience, they would have had no idea what the definition of a sophisticated and/or professional investor was. Our survey results indicate that none of the SilverLink tenant investors were aware of the sophisticated investor requirements, and none of them met the wholesale client eligibility test requirements (i.e., individual wealth test - assets of greater than $2.5 million and/or income exceeding $250,000; product value test – SNL investment equal to or greater than $500,000).

Worse still is that, as per our detailed timeline in the Appendix, the illegal SilverLink fundraising occurred during the period of time in which ASIC were undertaking investigation activities into the Sterling Group and their managed investment scheme (**MIS**) – the Sterling Income Trust (**SIT**). Considering the significant non-compliance issues, countless reports of misconduct, numerous stop orders and the eventual wind-up of the SIT, the fact that the Sterling Group was able to commence a new fundraising model without ASICs knowledge, beggars belief. Furthermore, once ASIC knew about SilverLink (13 April 2018), no formal action was taken until June 2018.

We fully support the introduction of more prescriptive consent requirements for wholesale clients (as we did for the introduction of product intervention powers in April 2019, and product design and distribution obligations in October 2021), but we must also point out that even if these requirements were implemented prior to the collapse of the Sterling Group, it still does not account for those who wilfully and maliciously conduct illegal fundraising activities, with no consideration of the impact on investors (retail or wholesale).

RECOMMENDATION 1

The client must be provided with the definitions of the categories that designate a wholesale client and must provide written consent attesting to the fact that they understand the conditions under which they are to be considered a wholesale investor.

[1] ASIC, *Senate Inquiry into Sterling Income Trust—Supplementary submission by ASIC,* https://download.asic.gov.au/media/vgwjlud3/asic-supplementary-submission-senate-inquiry-into-sterling-income-trust.pdf

Chapter 2. Suitability of scheme investments

Q5. Should conditions be imposed on certain scheme arrangements when offered to retail clients? If so, what conditions and why?

Q6. Are any changes warranted to the procedure for scheme registration? If so, what changes and why?

Q7. What grounds, if any, should ASIC be permitted to refuse to register a scheme?

The complexity of the SIT (and its predecessors, the Rental Management Investment Trust and the Rental Express Investment Trust) was highlighted in the Senate Economics References Committee Inquiry in 2019. Established in 2010, the Sterling Group eventually comprised around 50 companies and trusts focused on real estate related assets, with a complicated organisational and operational structure.

The responsible entity for the Sterling Group's MIS was Theta Asset Management (**Theta**). Up to and at the time of the collapse, the regulatory framework for a registered MIS relied on Theta, as the responsible entity, to ensure the MIS complies with the requirements of establishing and maintaining a MIS, and that the appropriate disclosure information was provided to potential investors. Unfortunately, as the 2019 SIT inquiry highlighted, the Sterling Group repeatedly engaged in misleading and deceptive conduct, and deliberately mislead investors about the suitability of the SIT. The inquiry also suggested changes to the legislative and regulatory settings due to the ease with which schemes that are novel, risky, illiquid, or speculative can be registered and sold in Australia.

Our survey results indicate that almost 90% of the respondents did not know they were investing in a MIS, as the Sterling Group directors and/or salespersons did not disclose this information. The remaining respondents who knew about the MIS provided us with conflicting feedback about their understanding of the MIS arrangements, which further demonstrates the misalignment between their understanding of product and how the product was designed, disclosed and marketed to them.

With regard to the tenant investors (both SIT and SilverLink), there was an added layer of misunderstanding, as they thought were buying a long-term lease (versus the reality that their funds were being used in the MIS), and that the income from their investment was supposed to cover future rental payments. Adding to this confused state was that the leasing arrangements are regulated by the state government (in WA, the Dept of Consumer Protection/DMIRS), whereas the investment part of the scheme is regulated by ASIC. There is anecdotal evidence that these two bodies did not cooperate effectively together. We have made further comment about this dual responsibility in a later section.

Following the collapse of the Sterling Group, we were astonished to find that the only requirements for ASIC to register a MIS is a basic checklist or simple administrative process, and not a merit review of the proposed MIS. We wholeheartedly agree with the statements in the CPA Australia's submission to the SIT inquiry:

> *…we believe it is reasonable for an individual considering investing directly into an ASIC registered MIS, that holds an ASIC issued AFS licence, to take a level of comfort that the company has had an appropriate level of assessment and oversight from the regulator, such that it is appropriate for that MIS to be commercially operating.*
>
> *…we question the appropriateness of the current regulation and oversight of registered MIS products if a commercially flawed business model can be approved and offered to the community. Of further concern is that often these products are complex and high risk, yet they are marketed directly to consumers through seminars and targeted advice.*
>
> CPA Australia, Submission, 8 November 2021, p. 2

We now know that even ASIC considered[2] the SIT to be *'too complex for retail investors'* and that it was *'not a commercially viable product'*. As detailed in our timeline in the Appendix, despite the long history of non-compliance issues, ongoing reports of misconduct, and early access to information about a scheme targeting vulnerable consumers, ASIC repeatedly opted to take 'no further action' until August 2017, six months after the DMIRS referral in March 2017, and 2½ years after the first report of misconduct was referred by FOS (February 2015).

Considering several directors of the Sterling Group have either been bankrupt (Mr. Jones was discharged from bankruptcy in February 2015), or close to bankruptcy[3], many are linked to previous catastrophic collapses (Monteath Properties ≈ $35 million; Westpoint ≈ $388 million; Finchley ≈ $45 million; Storm Financial ≈ $3 billion; Geneva Finance ≈ $30 million), and ASIC has previously been involved in court proceedings against Mr. Jones[4], we have serious concerns over ASICs current statutory obligations and limited refusal rights to register a MIS.

The Sterling case, despite its demise, also highlighted the demand for products that satisfy the requirements of a subset of retirees who wish to secure their housing needs in their retirement years. Obviously the investment model adopted by the Sterling Group was inadequate, however it does not mean that new products which meet the demand (and are sustainable), shouldn't become available at some point in time. It is unlikely that state or federal government sponsored social housing will meet this demand in the near future, so the private sector may see the opportunity to fill this gap in the market. Should such products eventuate we believe that the primary supervisory responsibility should be with ASIC (or its future equivalent), but that it be mandated that it liaise with any relevant State bodies.

RECOMMENDATION 2

ASIC to be given greater discretion in the MIS registration process, including the ability to review, approve and refuse the officers of the proposed MIS. Where the officers of the proposed MIS have a history of bankruptcy, company insolvency, deregistration for non-compliance issues, or have been officers of other previously failed MIS, they should be closely scrutinised.

RECOMMENDATION 3

ASIC to be given greater discretion to refuse an application to register a MIS by amending s601EB(1) of the Corporation Act to *'ASIC may register the scheme'* (rather than *'ASIC must'*), and include an additional clause that states *'unless there is any other reason which in ASIC's reasonable opinion justifies the refusal of the application'*.

Chapter 3. Scheme governance and the role of the responsible entity

Q8. Are any changes required to the obligations of responsible entities to enhance scheme governance and compliance? If so, what changes and why?

As discussed above, the responsible entity for the Sterling Group's MIS was Theta. Committee members of the Sterling First Action Group had many conversations with Mr. Robert Marie, the Managing Director of Theta regarding the collapse of the Sterling Group.

[2] Senate Order 1249, *Australian Securities and Investments Commission - Sterling group - Internal review*

[3] AFR, *Monteath may have traded while insolvent,* https://www.afr.com/property/monteath-may-have-traded-while-insolvent

[4] AFR, *Two former Geneva Finance directors in Perth court,* https://www.afr.com/companies/briefs

Below is an extract of one email exchange on 10 June 2019 with answers to questions regarding the management of SIT investments:

> *Q1. What is the mechanism by which monies were removed from SIT unit holders' trust accounts?*
>
> *A. Unit holders did not have trust accounts. Such statements were made by Sterling salespeople and were not correct.*
>
> *Q2. Who authorised the withdrawals?*
>
> *A. Funds were used as per the PDS and instructions were provided by the manager Sterling Corporate Services and reviewed by the responsible entity. If approved, they were processed.*
>
> *Q3. What is the responsible entity's role in this?*
>
> *A. As above.*

Prior to the collapse, SIT investors were receiving monthly statements that they thought had been showing their investment balance, and any dividends/distributions that had been paid. Within a week of the collapse, the balance of the accounts was reduced to zero. As the above exchange shows, the funds were used by the Investment Manager, Sterling Corporate Services (**SCS**, another Sterling subsidiary), and reviewed by Theta who did not see fit to raise any concerns with the SIT investors. Furthermore, Theta admit they were aware that false statements had been made in relation to the so called trust account, yet failed to inform the SIT investors.

We now know that these statements were not a true account of each SIT investor's account, and the trust accounts did not actually exist. Our survey results indicate that over 80% of the respondents were told by one or more Sterling Group directors that their investment would be held in a secure Trust account.

Sterling Group investors were kept in the dark about the deteriorating financial situation of the SIT. As detailed in our timeline in the Appendix, prior to the collapse ASIC had previously identified numerous non-compliance issues against Theta (as a responsible entity) for Sterling Group and/or its previous entities, including:

- issuing a stop order on the PDS for products associated with the Rental Management Investment Trust in February 2013,
- issuing a stop order on the PDS for products associated with the Sterling Income Trust in August 2017,
- failure to lodge financial reports between 2013 and 2019,
- failure to lodge an amended constitution in 2017, and
- additional non-compliance issues since 2010.

Additionally, the Compliance Breach Register for Theta as the responsible entity (released as part of FOI 061-2022)[5] details the following breaches associated with the Sterling Group and/or its previous entities:

- 3 x High Priority Incidents occurring from March 2014 to March 2018,
- 8 x Medium Priority Incidents occurring from October 2013 to August 2017, and
- 8 x Low Priority Incidents occurring from October 2012 to May 2018.

The Corporations Act sets out specific duties that Theta failed to conduct, which resulted in Mr. Marie being found guilty of breaches of the Corporations Act, fined and banned from acting in a similar capacity for a number of years. The issue we see here is that although Theta (and thereby Mr. Marie) were ultimately legally responsible for the day-to-day operation of the SIT, the recurring misleading and deceptive conduct by the Sterling Group directors ultimately resulted in 527 investors losing a total of $30,127,841. As authorised

[5] ASIC, *FOI Disclosure Log* https://asic.gov.au/about-asic/freedom-of-information-foi/foi-disclosure-log/

representatives of Theta, we believe the Sterling Group directors should be held to the same level of scrutiny as Theta and Mr. Marie.

We also understand that ASIC referred the matter to the Commonwealth Director of Public Prosecutions (**CDPP**) in October 2021, regarding the alleged misconduct of a number of officers of the Sterling Group. To date, no further information has been released, meaning the perpetrators of the many frauds and deceptions that occurred have not yet been held to account. Surely this sends the wrong signal to others who may be considering offering a MIS to the public?

Furthermore, the discrepancies between the obligations of a responsible entity/AFS licensee, and their authorised representatives was made abundantly clear for SilverLink tenant investors, when the responsible entity, Libertas Financial Planning Pty Ltd (**Libertas**) refused to comply with an AFCA[6] ruling in mid-2020. Case 655484 related to the SilverLink Investment Company and the sale of Preference Shares in return for a SNLL, where AFCA found in favour of the complainant. Libertas disputed the ruling, and it was escalated to the Ombudsman, who also found in favour of the complainant.

In August 2020, a final determination was made in favour of the complainant, with Libertas ordered to pay compensation of $268,207.57 for losses suffered because of the authorised representatives misleading and deceptive conduct. Libertas continued to dispute the ruling, using the November 2020 NSW Supreme Court judgement[7] in support of their refusal to comply with AFCA's determinations. This resulted in AFCA reviewing its jurisdiction to consider complaints lodged before 13 January 2021. Simply put, all AFCA complaints lodged by SilverLink tenant investors were then deemed to be outside the scope of AFCA's jurisdiction.

Nonetheless, AFCA made it clear that any complaint that falls outside the scope of AFCA's rules can still be considered if the responsible entity gives consent. Unsurprisingly, Libertas refused and advised they would not consent to AFCA considering the complaints[8].

What hope does an investor have if an authorised representative wilfully engages in misleading and deceptive conduct, the responsible entity refuses to comply with an AFCA ruling, and the only possible pathway to resolving a financial dispute (AFCA), is no longer an option?

RECOMMENDATION 4

In the event an authorised representative is appointed by an AFS licensee, the AFS licensee obligations (i.e., fit and proper person assessment, risk management systems, etc.), and the obligations of the responsible entity (i.e., acting honestly, exercising care and diligence, acting in the best interest of investors, compliance requirements, etc.), should flow down to the authorised representative.

We also fully support the recommendation below[9], originally published by the Senate Economics References Committee as part of the SIT inquiry.

RECOMMENDATION 5

The committee recommends that the Australian Government consider extending the Australian Securities and Investments Commission's public warning power to include situations where the Australian Securities and Investments Commission has reasonable grounds to suspect a financial product or credit product (or a class of such products) has resulted, will result or is likely to result in significant consumer detriment.

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6 Australian Financial Complaints Authority, Determination, Case number: 655484, https://service02.afca.org.au/CaseFiles/FOSSIC/655484.pdf

7 DH Flinders Pty Limited v Australian Financial Complaints Authority Limited [2020] NSWSC 1690

8 Sterling Income Trust Inquiry Report, para 3.42

9 Sterling Income Trust Inquiry Report, Recommendation 8, para 4.117

Chapter 5. Right to withdraw from a scheme

Q19. Is there a potential mismatch between member expectations of being able to withdraw from a scheme and their actual rights to withdraw? If so, how might this be addressed?

Our research[10,11] has found repeated instances of Sterling Group investors (or earlier versions of the company in 2012/13/14), reporting that their investments (shares, units, etc.) being rolled over from company to company, and never being able to withdraw from the MIS.

Since the collapse of the Sterling Group in May 2019, we have collected copies of product disclosure statements, information memorandums, marketing and promotional materials, contracts, deeds and other correspondence sent to investors. A detailed analysis of this evidence shows a clear path between the establishment, restructure, and then eventual closure of various Sterling Group entities, which continually prevented investors from withdrawing from the MIS. The examples below highlight the repeated rollover of investors' shares/units due to alleged corporate restructuring and/or proposed ASX listing:

- 8 April 2013: Product Disclosure Statement for corporate restructure of Rental Management Australia Fund into the Rental Management Investment Trust; also references upcoming ASX listing.
- 30 April 2014: Letter sent to Heritage Acquisitions Limited investors, gifting them shares in Sterling First Group Ltd or units in the Rental Management Investment Trust, to replace their current shares in Heritage; also references upcoming ASX listing.
- 15 April 2015: Letter sent to investors regarding allocation of shares in Sterling First Limited, due to consolidation of all pre-existing Sterling Group companies; references delaying proposed ASX listing.
- 1 February 2016: Letter sent to Sterling First Limited investors, announcing corporate restructure and gifting them shares in Sterling First (Aust) Limited to replace their current shares in Sterling First Limited; also references the delayed ASX listing.
- 5 May 2016: Letter sent to Sterling Wholesale Property Rights investors, announcing corporate restructure and subsequent conversion of their investment into units in the Sterling Seniors Property Trust.
- 20 April 2017: Letter sent to Sterling Wholesale Property Rights investors, announcing conversion of investment to either units in the Sterling Income Trust, or shares in Sterling First (Aust) Limited; also references new efforts for upcoming ASX listing.
- 20 June 2017: Letter sent to Sterling First (Aust) Limited investors, announcing changes to Class 2 Performance Shares due to ASX listing, reallocation of investors' share holdings and changes to subsequent dividends payments.
- 1 February 2018: Email sent to Sterling First (Aust) Limited investors, with instructions to convert all preference shares to ordinary shares to enable ASX listing, and cancellation of upcoming dividend payment on preference shares.

Investors were also informed that the SIT was considered non-liquid, but that they could withdraw from the MIS by providing 6 months' notice. Several applications to withdraw were made by a variety of investors, but none were acted upon even when the application was made more than 6 months in advance of the eventual collapse and administrator appointment. While we do not have any specific recommendations on how to address the potential mismatch between member expectations to withdraw and their actual rights to withdraw, we support any improvements to the current regulatory framework that would provide greater transparency for investors and more accountability for responsible entities (and any authorised representatives).

[10] Hot Copper Forums, Sterling First Pre IPO, https://hotcopper.com.au/threads/sterling-first-pre-ipo.3351345/

[11] Whirlpool Forums, Sterling First (Aust) Limited, https://forums.whirlpool.net.au/thread/9mn2vx23

Chapter 6. Winding up insolvent schemes

Q20. Are any changes required to the winding up provisions for registered schemes? If so, what changes and why?

We would like to highlight the current regulatory gaps impacting investors of an insolvent MIS and their inability to access the professional indemnity insurance (**PII**) policy that is mandated by the Corporations Regulations. AFCA Case 667682 (against Theta) is a very good example of this. In March 2020 a determination was made in favour of the complainant, with Theta ordered to pay compensation of $118,957.60 for losses suffered due to the authorised representatives misleading and deceptive conduct.

As the responsible entity, Theta should have been responsible for paying the determination, however they declared insolvency in December 2019, with Worrells Solvency & Forensic Accountants (**Worrells**) appointed as the administrators. As a result, the complainants were required to liaise directly with Worrells to make a claim against Theta's PII policy. The claim was successful, however an amount of $100,000 was deducted, with the insurer claiming this was the amount of excess stipulated in the policy. Therefore, the actual amount of compensation that was paid was reduced to $18,957.60 from which the liquidator then deducted a $614.60 administration fee.

Despite enquiries by AFCA and lawyers representing the complainant, the insurer refused to provide a copy of the PII policy (citing confidentiality), so we were unable to verify the veracity of the excess amount. They have however, confirmed that the excess clause would be applied against every claim made. This matter was raised with the Chief Operating Officer of AFCA, and astoundingly, the insurer again refused to provide AFCA with access to the insurance policy. On 9 June 2020, ASIC officers met with Worrells to discuss the letter AFCA had sent to ASIC about this matter on 28 May 2020. ASIC sent a report of their meeting to AFCA dated 19 June 2020, but have stated a FOI request must be submitted to view this and it would be handled at the discretion of the ASIC officer handling the request.

This also raises the critical point that if the PII policy existed, even with the excess clause, why did AFCA not continue to process more determinations so that victims could at least recover part of their losses? It appears the answer lies in the fact that AFCA were not receiving remuneration for any work once Theta were placed in liquidation, as AFCA *'…gets most of its revenue from fees charged to companies for resolving complaints'.* This was further confirmed by AFCA CEO David Locke in June 2020[12], as he reportedly stated, '*When we take on cases with organisations that are or become insolvent, we are doing work that we don't get paid for'*.

As a not-for-profit organisation, we understand that AFCA rely solely on fees/levies (membership and complaint resolution) for revenue. However, it is clearly evident the two major protections that should apply to an independent external dispute resolution (**EDR**) scheme have failed - an effective EDR cannot exist when it is dependent upon payment of fees by one of the parties, and there appears to be no verification to ensure the PII policy terms are adequate to provide true protection to the people most vulnerable – the investors.

In our opinion there are two clear regulatory gaps associated with involvement MIS that need to be urgently addressed:

1. AFCA does not currently process complaints against companies in liquidation as they are not funded to do so, meaning victims of an insolvent financial firm cannot access the mandated PII policy.

2. MIS are currently excluded from the Compensation Scheme of Last Resort (**CSLR**), meaning that even if AFCA recommences processing complaints against insolvent firms and finds in favour of the complainants, the complainants cannot access the CSLR to recoup the losses suffered as a result of the disproportionate excess clauses on the mandated PII policy.

[12] AFR, Budget crisis for financial watchdog sparks case freeze, https://www.afr.com/companies/financial-services/budget-crisis-for-financial-watchdog-sparks-case-freeze

We do not have any suggestions for changes to the winding up provisions for registered MIS, however we do have recommendations on the minimum PII policy requirements.

RECOMMENDATION 6

ASIC to require all AFS licensees to submit their PII policy details as part of their annual compliance requirements to ensure the terms of cover remain adequate for the purposes of the Corporations Act.

RECOMMENDATION 7

Current and prospective members of AFCA must provide a copy of their current PII policy to be deemed eligible for an AFCA membership. Regulatory changes should also be implemented giving ASIC the power to enforce AFCA requests for information.

Chapter 7. Commonwealth and state regulation of real property investments

Q23. Do issues arise for investors because of the dual jurisdictional responsibility when regulating schemes with real property? If so, how could they be addressed?

Issues certainly did arise because of dual jurisdictional responsibility in the case of the Sterling Group. As discussed previously, there was an added layer of misunderstanding for SNLL tenant investors, as they thought were buying/paying for a long-term lease (via a residential tenancy agreement), and did not understand they were also investing in a MIS, where their tenancy arrangements were linked to the performance of the MIS.

Depending on when they executed their SNLL agreement, the tenant investors were given two options[13]:

1. Investment in the SIT, with distributions used to pay the rent and any surplus reinvested. Under this option the tenant investors generally had a lease directly with the landlord.

2. Investment in preference shares in SilverLink, which held units in the SilverLink Income Rights Trust (**SIRT**). Rent was paid directly by the Sterling Group under a head lease with the landlord and a sub-lease provided to the tenant investor.

Marketing materials for the SNLL arrangements emphasised that after the initial investment was made in the SIT or SilverLink, that no further payments would be required from the tenant investors (i.e., no ongoing rent or additional fees/costs). However, as AFCA[14] determined in Case 667682 (against Theta), the Sterling Group *'…failed to disclose the risk that distributions would be insufficient to cover rent, that the capital investment could be depleted and did not disclose the risk to their security of tenure if the SIT could not fund the rental payments'*.

Many of the tenant investors sold their family home to fund their SNLL, losing their only real assets in the process. Some actually sold their home to the Sterling Group, who then signed them up to a SNLL in the property. An example of this is Mr G, who sold his home of 45 years to Sterling in April 2015 for $370,000 and then paid $270,000 for a 20-year lease on the home.

Our investigations have revealed that even though the registered owner of Mr. G's property is Acquest Property Pty Ltd (a Sterling subsidiary, now in administration), the mortgage on the property was registered to a company by the name of Vermis Pty Ltd. The director this company? A director/ex-director of the Sterling

[13] Ferrier Hodgson, Stirling First (Aust) Limited (Administrators Appointed) – Voluntary Administrators' Report – 30 May 2019, p. 13.

[14] Australian Financial Complaints Authority, Determination, Case number: 667682, https://service02.afca.org.au/CaseFiles/FOSSIC/667682.pdf

Group. Vermis Pty Ltd had a mortgage against the property valued at $250,000 meaning that after the Sterling Group/Acquest purchased the property from Mr. G, they then used it as collateral against something else. In a similar situation are tenant investors Mr. & Mrs. H, based in Queensland. In February 2018 they paid $210,000 for a lifetime lease on a property that is owned by Richmond Assets Pty Ltd. And who was the director of that company? Mr Bruce Monteath, an ex-director of the Sterling Group, with links to a variety of corporate collapses.

Another example is Ms. D, who signed a contract with the Sterling Group to build a property that would then be leased out to a SNLL tenant investor. From the documentation we have received, it appears the property was not constructed in accordance with the council approved plans (approved plans were for a single residence with an attached granny flat/teens retreat; the build completed was a dual key occupancy with two separate residences). As a result, Ms. D was ordered to return the property to the specifications initially approved by the council. This was not the only dual key property that had construction issues, with several also missing a central dividing firewall, which is a direct violation of the Building Code of Australia.

On the other side are the landlords who signed up to lease their property to the Sterling Group and were then faced with tenant investors who led to believe they had paid their rent in advance (via their SNLL). As a result, disputes between SNLL tenant investors and landlords arose not long after the collapse of the Sterling Group, as the rental payments to landlords ceased. Shockingly, many landlords also reported their rental payments had actually stopped in mid to late 2018, over 6 months prior to the collapse of the Sterling Group.

Multiple civil proceedings between landlords and SNLL tenant investors were initiated after the collapse, the first[15] in 2019 involving three tenant investors and one landlord. The case deliberated the validity and use of:

- Short term management authorities between the landlord and Rental Management Australia (**RMA**, an entity of the Sterling Group), with the landlord specifying they wanted short term tenants only as they were preparing to sell the properties,
- Real property put option agreements to sell the properties to Acquest Property Pty Ltd (**Acquest**, an entity of the Sterling Group),
- Short term head leases between the landlord and either SCS or SHL Management Services Pty Ltd (**SHL**, an entity of the Sterling Group), which were executed by RMA on behalf of the landlord,
- Long term head leases between the landlord and either SCS or SHL, which were executed by RMA on behalf of the landlord,
- Short term subleases between the tenant investors and either SCS or SHL,
- Long term subleases between the tenant investors and either SCS or SHL, and
- Lodgement of caveats by the tenant investors.

In addition to the $805,500 paid by the three tenant investors to the Sterling Group, there were added complexities affecting each tenant investor's SNLL agreements. This includes the dates the various long term head and subleases were executed conflicting with the execution of the short term management authorities, and the addition of short term head leases and subleases several days after the initial long term head and subleases were executed.

Even more concerning is the long term head leases were executed by RMA on behalf of the landlord, in direct violation of the short term management authority, and the short term subleases were added after the fact. The tenant investors were advised by the Sterling Group that their initial long term sublease was still valid, and would come into effect upon the expiry of the short term sublease. This was in fact false, and each tenant

[15] Murphy Toenies v Family Holdings Pty Ltd as trustee for the Conway Family Trust [2019] WASC 423

investor was served a notice to vacate from the landlord within several months of moving into their SNLL properties.

In early 2019 caveats were lodged over each of the three properties owned by the tenant investors, claiming a leasehold estate being a sublease on the terms entered into in the long-term sublease. Justice Smith agreed that there was an arguable case, and it should be fast tracked to an early trial. We are unaware of the outcome, as no trial occurred (that we know of), so the legality of the caveats appears to still be undetermined. Add to this is the misleading and deceptive conduct, and false representations made by the Sterling Group, which the both the landlord and three tenant investors relied upon, we have four parties that have suffered irreparable financial losses.

In the other two civil cases[16] in 2021 between landlords and tenant investors, the court determined the non-recourse clause in the residential tenancy lease did not prevent the landlord from terminating the lease for non-payment of rent. The non-recourse clause implied the tenant investor's investment into the SIT or SilverLink (and therefore the distributions/dividends from their investment) would be sufficient to cover their rental payments for the duration of their SNLL, and in the event there was a shortfall, the tenant investor was not liable. As stated by Mr Gary Newcombe (former Western Australian Commissioner for Consumer Protection), at the SIT inquiry:

> *This has produced the situation where the court found that the landlord was able to terminate the lease, even though the deed basically said if rent was not paid the tenant was not liable for it, because that was in conflict with the standard-form provisions of the Residential Tenancies Act, which give the landlord the right to terminate a lease for non-payment of rent. But the provisions in the deed which were effective prevented the landlords from seeking to recover unpaid rent.*
>
> Proof Committee Hansard, 16 November 2021, p. 27

As the five cases discussed above have highlighted, the structure of the Sterling Group MIS was split between several regulatory jurisdictions – ASIC for the MIS, WA DMIRS (for the WA based tenant investors), and the QLD Department of Housing (for the QLD based tenant investors).

We fully support the two recommendations below[17], originally published by the Senate Economics References Committee as part of the SIT inquiry.

RECOMMENDATION 8

The committee recommends that the Australian Government work with state and territory governments to clarify the jurisdictional overlap between Commonwealth and state regulation of financial products. In particular, the Australian Government should review investment schemes that include real property rights, including accommodation, leases and tenancy rights under state and territory laws.

RECOMMENDATION 9

The committee recommends that the Australian Government review the marketing of, and financial advice for, investment products which deal in real property interests and whether or not sufficient protections are available for investors in these products.

16 Soussa v Thomas [2021] WASC 172; Hassell v Yates [2021] WASC 389

17 Sterling Income Trust Inquiry Report, Recommendation 9, para 4.118 and Recommendation 10, para 4.119

Chapter 8. Regulatory cost savings

Q24. What opportunities are there to modernise and streamline the regulatory framework for managed investment schemes to reduce regulatory burdens without detracting from outcomes for investors?

In the absence of a strong corporate watchdog, a safety net needs to be in place for MIS that fail. Please refer to our submission to the Treasury on the scope of the CSLR for details of why we believe MIS should be included. Such a scheme would increase investor confidence, which in turn would have a beneficial impact on investment opportunities in Australia.

Appendix 1 – Sterling Group Chronology

To assist the Treasury with context to some of our answers, below is a summarised timeline of the events leading up to the collapse of the Sterling Group.

Date	Event
Pre-2010	ASIC notes a Sterling Group director has some antecedent history with ASIC since the 1990's. This includes reports of misconduct regarding other MIS he operated (failure to provide adequate information about financial standing of investments and payment of investment returns). He was also the subject of a few investigations in the 1990s.
2010	First Sterling Group companies formed
2010-2012	ASIC notes multiple non-compliance issues against Theta Asset Management (Theta) as a responsible entity.
5 June 2012	Rental Express Investment Trust registered with ASIC as a MIS. Theta was the Responsible Entity of the RMIT and was the operator of the MIS.
23 October 2012	MIS renamed to Rental Management Investment Trust (**RMIT**).
November 2012	Report of misconduct lodged with ASIC by Financial Services Ombudsman relating to concerns of misleading conduct.
February 2013	Stop order issued by ASIC for products associated with the RMIT.
18 November 2013	ASIC receives breach report from Theta relating to failure to lodge financial reports for the RMIT.
3 February 2015	Report of misconduct lodged by Financial Services Ombudsman relating to concerns of misleading conduct.
20 May 2015	MIS renamed to Sterling Income Trust (**SIT**).
18 June 2015	Report of misconduct lodged by ASIC officer expressing concerns of misleading or deceptive conduct.
Early 2016	Sterling New Life Lease (**SNLL**) product launched.
9 September 2016	Report of misconduct lodged by investor citing misleading investment information, and inability to redeem their investment.
29 September 2016	ASIC receives breach report from Theta relating to failure to lodge financial reports for the SIT
30 September 2016	ASIC receives breach report from Theta relating to failure to lodge financial reports for the SIT
16 February 2017	ASIC receives breach report from Theta relating to failure to lodge an amended constitution
17 March 2017	Report of misconduct lodged by WA DMIRS regarding insufficient information being supplied regarding Sterling New Life Leases (**SNLL**).
23 May 2017	Report of misconduct lodged by investor citing misleading investment information, and inability to redeem their investment.
7 August 2017	Internal ASIC communications (IMS to Corporations) regarding possible fundraising by the Sterling Group without a prospectus.

Date	Event
9 August 2017	Interim stop order issued by ASIC in relation to the product disclosure statements (**PDS**) for products associated with the SIT.
11 August 2017	ASIC identifies misleading statements used to promote SNLL on the Sterling website.
28 August 2017	ASIC receives breach report from Theta relating to failure to lodge financial reports for the SIT.
29 August 2017	Final stop order issued by ASIC in relation to the PDS for products associated with the SIT.
September 2017	Sterling Group continues sale of SIT products under a revised PDS issued by Theta.
29 September 2017	ASIC representative attends Sterling Group seminar on SNLL and the associated investments. When the representative enquired about the PDS, they were told that Sterling was listing on the ASX and that was delaying the release of the PDS.
29 September 2017	SIT Financial Statements and Reports for 2016/17 financial year lodged with ASIC, with Auditor stating, *'a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern'*.
27 October 2017	Sterling Group continues sale of SIT products under a revised PDS issued by Theta.
23 November 2017	Internal ASIC communications (IMS to Corporations) regarding Sterling advising investors they were listing on the ASX.
4 December 2017	ASIC analysis of the 2016/17 accounts concludes there are *'serious concerns with the financial viability of the SIT'.*
December 2017	Sterling Group commences fundraising under the name of SilverLink (SilverLink Securities and SilverLink Investment Company registered as new entities of the Sterling Group). Sterling promoted the sale of redeemable preference shares to sophisticated investors in exchange for a SNLL. No PDS was issued.
13 March 2018	ASIC receives breach report from Theta relating to failure to lodge financial reports for the SIT
February 2018	ASIC officer expresses interest in stopping new investors from investing in SIT products.
4 April 2018	ASIC directs Sterling Group to cease all advertising and promotional due to concerns about misleading and deceptive statements on its website
April 2018	WA DMIRS notifies ASIC about the SilverLink preference shares.
19 April 2018	ASIC determines they have sufficient information that is *'helpful in developing the case against Theta and convincing Theta to voluntarily wind up the SIT'.*
30 April 2018	Theta withdraws the PDS for the SIT.
29 May 2018	ASIC launches formal investigation into the Sterling Group and the SIT.
22 June 2018	ASIC meets with Theta and Sterling director, advises SilverLink offering *'appeared to be illegal in circumstances where there was no prospectus and SilverLink as not an AFSL holder'*.
8 August 2018	ASIC conferenced with Theta, where ASIC details the various issues they have with the MIS ((including issues regarding asset valuation, unit pricing, ownership of Rental Management Agreements, disclosure of losses and reliance on support from manager to pay distribution).

Date	Event
	ASIC noted the product offering was *'too complex for retail investors, particularly the targeted demographic of vulnerable elderly investors'* and it was *'not a commercially viable product'.*
18 August 2018	Theta advised ASIC of its decision to wind up all unit classes/investment products in the SIT.
27 August 2018	Winding up of the SIT officially commences.
October 2018	Theta assures ASIC that SNLL tenant investors would be made whole (i.e., their losses would be restored).
4 December 2018	Tenancy WA notifies ASIC about Sterling Group continuing to raise funds through the offer of investments in SilverLink.
14 December 2018	ASIC requests Sterling Group directors to stop any further offering of SilverLink products and to sign written undertakings.
17 December 2018	Sterling Group directors provide signed written undertakings to cease accepting funds for SilverLink investments.
December 2018	Sterling Group contact several existing tenant investors, proposing a further investment in Australian Rental Trust (**ART**), Gage Management Ltd and Acquest Capital Pty Ltd. He promoted the Sterling Group's apparent ASX listing,
December 2018-February 2019	Sterling Group continues sale of SilverLink products and signs up new investors for SNLL investments.
October 2018-May 2019	Sterling Group actively fundraise via the ART, and sign-up more investors for SNLL.
3 May 2019	Voluntary administrator appointed to Sterling Group.
10 June 2019	Sterling Group placed into liquidation.
11 December 2019	ASIC commences Federal Court action against Theta and Mr. Robert Marie.
March 2020	Theta placed into liquidation.
19 December 2020	Federal Court finds Theta and Mr. Marie contravened the Corporations Act on multiple occasions in authorising the issue of five defective PDS for the SIT.
15 October 2021	ASIC refers the matter to the CDPP.

Appendix 2 – Victim Survey

A total of 64 victims participated in the ***Sterling First Action Group: Treasury MIS Submission***.

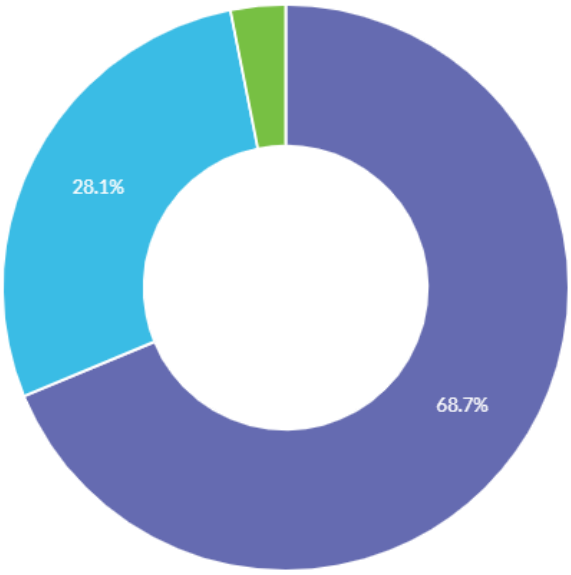
We received responses from a variety of victims of the Sterling Group collapse. For ease of data collection, the victims are categorised into three broad categories:

1. **TENANTS WITH STERLING NEW LIFE (SNL) LEASES:** The tenants upfront rental payment (their investment) went into two different funds – either the Sterling Income Trust or the SilverLink Investment Company.
2. **PROPERTY OWNERS/LANDLORDS:** Leased their property to the tenants via a subsidiary of the Sterling Group. Lease arrangements were complex and varied significantly, with many owners not having received rental income for over 4 years.
3. **SHAREHOLDERS:** Invested in a variety of shares or units in different Sterling Group entities. Some shareholders have had their original investment rolled over several times (i.e., Heritage to RMIT, RMIT to Sterling First Australia, Sterling First Australia to Sterling Income Trust, and so on).

In some instances, tenants and owners/landlords were also encouraged to invested in shares/units. To ensure accuracy of the data collection, survey respondents were asked to categorise themselves into one of the three categories that best described their situation.

Survey Results

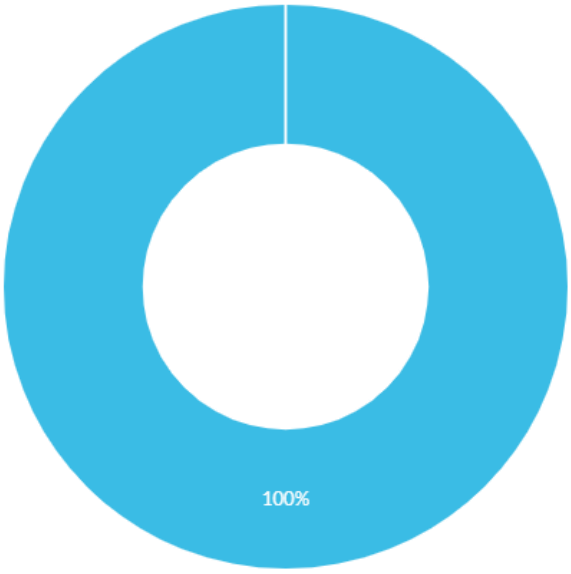
▶ **Which of the following best describes you (or the person/s you represent)?**



Respondents 64 Answered 64 Unanswered 0

	CHOICE	TOTALS	%
●	Tenant/s affected by collapse of the Sterling Group	44	68.7%
●	Investor/s affected by collapse of the Sterling Group	18	28.1%
●	Landlord/s (Property Owner/s) affected by collapse of the Sterling Group	2	3.2%

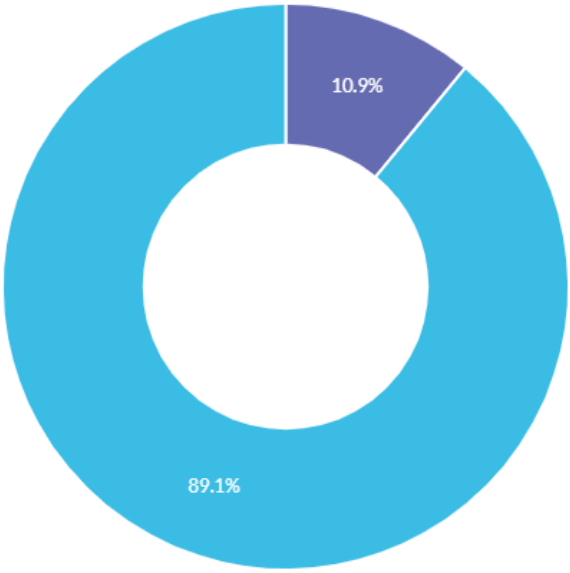
▶ **Would you have invested in Sterling Group products (shares, units, lifetime lease, etc.) if you had known the past history of the directors and/or responsible entity?**



Respondents 64 Answered 64 Unanswered 0

	CHOICE	TOTALS	%
●	Yes	0	0%
●	No	64	100%

▶ **Was the term Managed Investment Scheme (MIS) ever mentioned to you?**

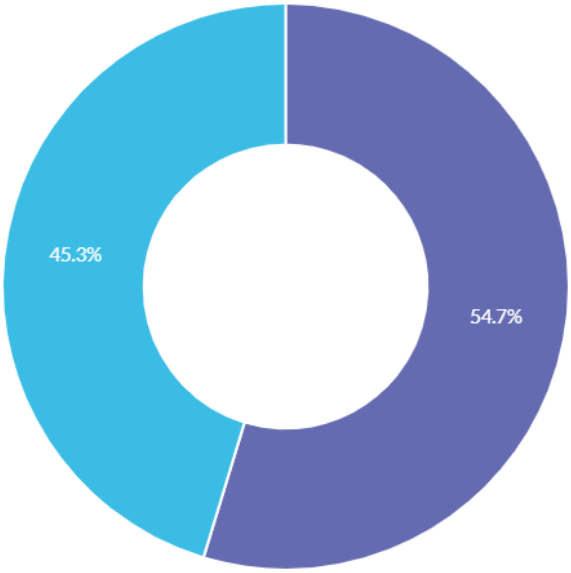


Respondents 64 Answered 64 Unanswered 0

	CHOICE	TOTALS	%
●	Yes	7	10.9%
●	No	57	89.1%

▶ **If yes, what is/was your understanding of the Sterling Group's Managed Investment Scheme (MIS)?**
They managed investment properties to produce a profit to return to investors.
Funds were held in an actual Trust. The funds held in the Trust were then used for aged care property development secured against the land and the property under development. Minimum risk was involved as the funds used for development of such properties were leased back from the original owners.
My understanding was that there were a number of investment options under a number of what seemed to be very convoluted parameters. Each with varying degrees of security and risk. What was emphasised was that all monies were secured and protected by an authorised trustee and therefore the monies were protected in case of anything untoward occurring.
% return on money loaned to company
Our money given to Sterling and invested so that our lease was covered for the rest of our life.
We would invest in a rent free property for 40yrs, and our money would be put aside in a trust fund.

▶ **Were you told that the Sterling Group and/or the investment product (RMIT, SIT, etc.) was going to be listed on the ASX?**



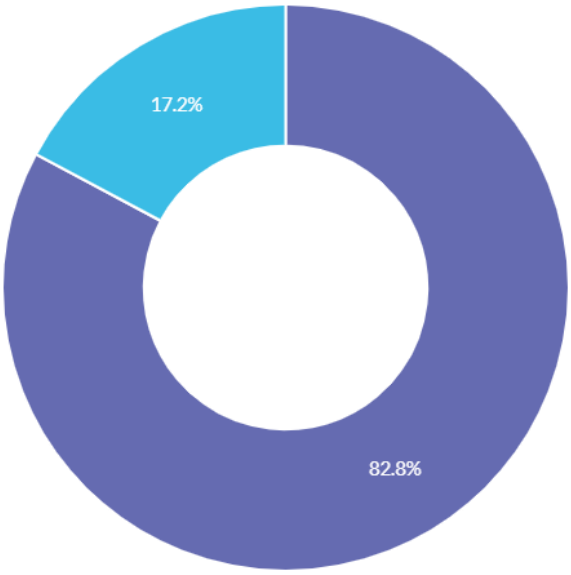
Respondents 64 Answered 64 Unanswered 0

	CHOICE	TOTALS	%
●	Yes	35	54.7%
●	No	29	45.3%

► **If yes, what is/was your understanding of the proposed ASX listing?**
Whenever I wanted to sell / cash out of the units I had in Sterling First (Management Company Units, Development Units, Co-Dev units), I was advised not to do so as the ASX listing was imminent. Later down the track, the Sterling First management team also advised that the listing had been submitted to the various authorities and was awaiting final approvals for listing. *As the listing was imminent I was unable to cash out my unit holdings in Sterling and would have to wait for the ASX listing. There were also some webinars provided by Quang Nguyen on the pre-IPO which provided many false promises.*
There would be an opportunity for investors to purchase shares pre-IPO to gain capital gains after listing.
We were told that Sterling was working with ASIC to clear a few things before being listed on the ASX.
That the dividends paid on the investment would cover rent costs and would be paid to the landlord by the Sterling Group.
Ryan Jones told me the shares were going to be listed within weeks. I gave him a cheque for $20,000.
Would further develop the Company and provide more aged people with long term rental properties and the money would be secure.
We bought at 20 cents a share and was told repeatedly told that they are looking confidently at listing at $1.00 per share on the ASX. We bought 2 lots at $20,000 each.
That it would be registered in 2019 and was set for high growth.
Only after our invested funds were not returned to us on promised due date, we were informed that these funds were going to be turned into shares.
That the Sterling Group was going to be listed on the stock exchange as a public company.
The investment we had would be listed as shares on the ASX where they expected the shares would double in a short period so we could sell them to receive the profits they had promised / predicted.
That they were a safe option if listing on ASX as they would have been thoroughly screened before being able to list.
Our understanding was that the ART was to be listed on the ASX. The funds which were invested were expected to rise in value. We would be paid dividends which would cover our rent. Over time these funds would increase.
Simon Bell and Andy Falkingham confirmed that the company was being listed imminently and because we were already clients, we could buy shares. This turned out to be a lie.

I was told the shares were to be listed within a month or two and they were worth 25 cents each, and as soon as they were listed, they would double in price.
It kept getting delayed. I chased them over 18 months and kept getting told the same thing. It's happening but not yet. Once the listing occurred, the share price would increase. The shares I purchased were at a low price (I bought $10,000 worth) + my $40,000 in the Sterling First Trust.
My seller told me that the product was doing really well and was soon to be listed on the ASX. He said the share price was getting higher and that the early investors would make a lot of money because the product was doing so well. It was his enthusiasm (or selling skills) that pushed me into buying shares and investing in the SIT on top of buying my life lease for the home I moved into.
It was supposed to be listed in 2012 but never happened. Excuse after excuse from Ray Jones.

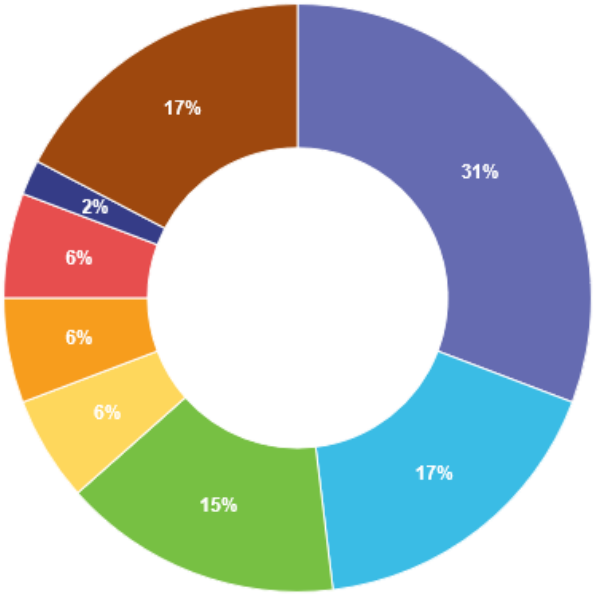
► **Were you told your investment was safe because it was in a secure Trust account?**



Respondents 64 Answered 64 Unanswered 0

	CHOICE	TOTALS	%
●	Yes	53	82.8%
●	No	11	17.2%

▶ If yes, who gave you this information?



Respondents 64 Answered 52 Unanswered 12

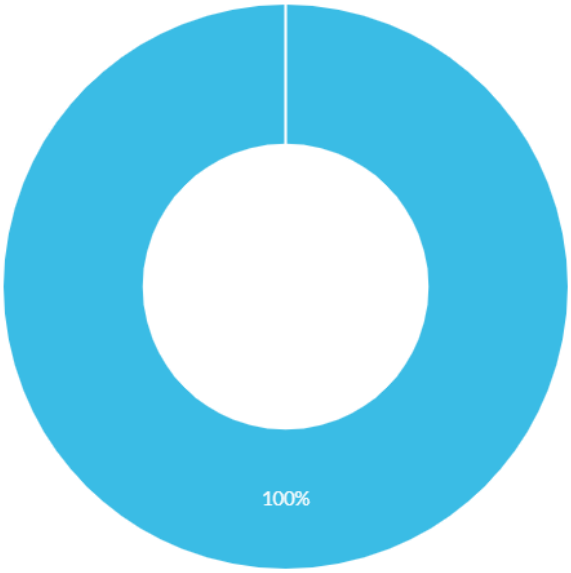
	CHOICE	TOTALS	%
●	Ryan Jones (former Director)	16	31%
●	Philip Lucks (former Director)	9	17%
●	Ray Jones (former Director)	8	15%
●	Quang Nguyen (former Director)	3	6%
●	Brian Ruzic (former Director)	3	6%
●	Mark McKeown (former Director)	3	6%
●	Simon Bell (former Director)	1	2%
●	Other (i.e., former sales consultants)	9	17%

▶ **Did you seek financial/legal advice prior to investing in a Sterling Group product (shares, units, lifetime lease, etc.)?**

Respondents 64 Answered 64 Unanswered 0

	CHOICE	TOTALS	%
●	Yes	28	43.8%
●	No	36	56.3%

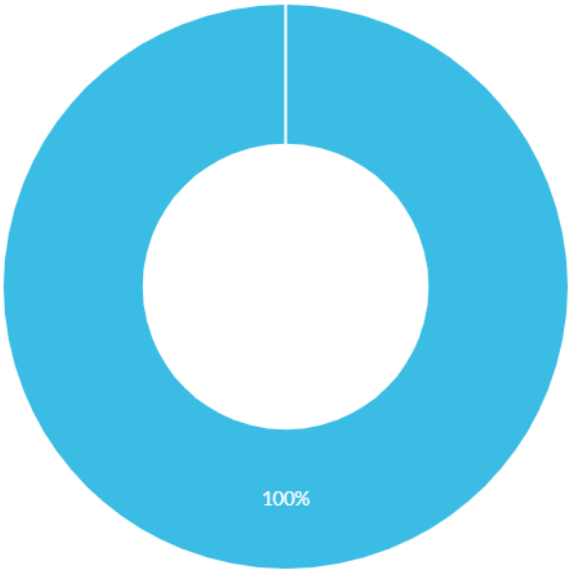
▶ **If you invested in SilverLink, was the concept of a sophisticated investor explained to you?**



Respondents 39 Answered 39 Unanswered 0

	CHOICE	TOTALS	%
●	Yes	0	0%
●	No	39	100%

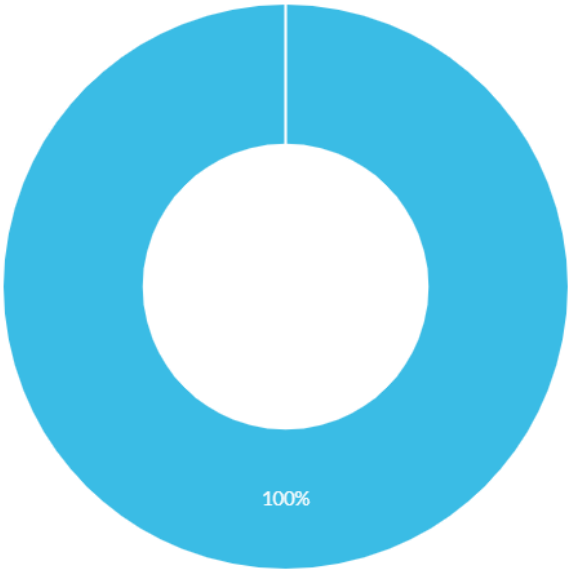
▶ If you invested in SilverLink, did you have assets of greater than $2.5 million and/or income exceeding $250,000?



Respondents 39 Answered 24 Unanswered 15

	CHOICE	TOTALS	%
●	Yes	0	0%
●	No	24	100%

▶ If you invested in SilverLink, did you pay more than $500,000 for your rental agreement?



Respondents 39 Answered 21 Unanswered 18

	CHOICE	TOTALS	%
●	Yes	0	0%
●	No	21	100%