Committee	Senate Economics References Committee
Inquiry	Inquiry into Sterling Income Trust
Question No.	001
Reference	Written
Committee member	Senator Pratt

Questions

1. **When did ASIC first get correspondence from WA consumer affairs or the WA government in relation to the Sterling group?**

   ASIC first received correspondence from the WA government in relation to the Sterling Group on 17 March 2017, when ASIC received a report of suspected misconduct from the Western Australian Department of Mines, Industry Regulation and Safety (Consumer Protection Division) (**DMIRS**). The nature of the DMIRS report to ASIC, and ASIC's response to that report, is described at paragraph [147] – [170] of ASIC's written submission to this inquiry (**ASIC submission**).

2. **What complaints had ASIC received before then?**

   Prior to the DMIRS report on 17 March 2017, ASIC had received two reports of misconduct and one consumer complaint. The two reports were received on 3 February and 18 June 2015. The consumer complaint was received on 16 September 2016. Neither the reports nor the complaint related to the Sterling New Life Lease or the Sterling Income Trust. All three were assessed according to ASIC's normal regulatory criteria and it was determined that no further action was warranted.

   The first report of suspected misconduct was from the Financial Services Ombudsman (**FOS**) on 3 February 2015. A retail investor was allegedly misled by Sterling Corporate Services (then known as Rex Corporate Pty Ltd) into investing in a wholesale trust in October 2012. Rex Corporate was not an authorised representative of an AFSL holder until November 2012.

   Between 4 February 2015 and 5 May 2015, ASIC reviewed the materials and spoke with contacts at FOS. ASIC decided that no further action be taken, due to the age of the alleged conduct, the fact that Sterling Corporate had since become an authorised representative of an AFSL licence holder, and the lack of relevant antecedents.

   The second report of suspected misconduct was a referral from an ASIC staff member about a newspaper advertisement for a "free seminar on the benefits of co-ownership". The relevant ASIC team reviewed the advertisement and website for Sterling First Project Pty Ltd and, on 10 July 2015, recommended no further action because the company held a real estate licence and appeared to be offering real estate investment advice only (and therefore not in ASIC's jurisdiction).

   On 9 September 2016, ASIC received a complaint from an individual who had invested in Sterling Residential Development Syndicate (Aust) Pty Ltd in respect of a property development scheme which promised returns of around 20% per annum. The individual complained that he had been misled about his ability to redeem his investment. Between 13 September 2016 and 23 January 2017, ASIC had several telephone calls with the complainant and reviewed the materials he provided. On the information provided, and

from ASIC's further inquiries, ASIC formed the view that no further action was warranted.

3. **How many complaints did ASIC receive and on what dates were these complaints received?**

   Please see the answer to the previous question above regarding complaints received prior to DMIRS's report of suspected misconduct to ASIC on 17 March 2017.

4. **When did ASIC start investigating these complaints?**

   Please see the answer to Question Two above.

5. **ASIC had said previously that they had thought the issue was outside their jurisdiction because they had viewed the matter as a tenancy issue, when did ASIC confirm that this was not the case and take responsibility for it?**

   ASIC has acted, investigated, taken enforcement steps and taken responsibility for matters within its jurisdiction. Importantly, not all of the Sterling Group's activities fell within ASIC's jurisdiction. For instance, the offering of residential tenancies is governed by specific State laws (as well as the Australian consumer law) and those laws are administered by State regulators.

   As the financial services regulator, ASIC regulates financial products and services. This includes the Sterling Income Trust and the Silverlink redeemable preference shares, and ASIC has always recognised that these matters are within its jurisdiction.

   Under the legislation ASIC administers, it does not have jurisdiction over real estate and tenancy matters, including residential tenancy agreements, and the licensing and conduct of real estate agents. In the case of the Sterling New Life Lease and its WA tenants, the relevant regulator is DMIRS, as the regulator responsible for the licensing and supervision of real estate agents and administering laws in relation to residential tenancies.

   The Sterling Life Lease appears to have been offered under a range of different documents over the period 2016-2018. The Sterling New Life Lease offered by the Sterling Group could, on the face of at least some of the contractual documents, be entered into without investing in the Sterling Income Trust or Silverlink. The two arrangements were legally and/or structurally independent. However, the commercial reality was that the most likely means by which a tenant-investor would participate would be by entering into both a Sterling investment and the Sterling New Life Lease.

   The SNLL product and accompanying investment involved a complex set of contracts and disclosure documents. We have reviewed these documents as they related to some of the tenant-investors and they involved lengthy, complex and technical disclosures, contracts and deeds. As discussed in paragraphs 66–70 of the ASIC submission, court cases seeking to resolve the proper interpretation of some of these documents are ongoing.

   Annexure A contains examples of two documents which were provided to tenant-investors prior to the entry into a SNLL, being an ‘Overview’ and a ‘Pre contractual disclosure booklet’. These documents were provided to ASIC by WA DMIRS as part of their referral.

Annexure B contains the WA Supreme Court case that considered the operation of a 'Sterling Income Trust type' of SNLL – Soussa v Thomas – handed down in June 2021 and a summary of the case. It also includes an example of documents from a "Sterling Income Trust" type SNLL, involving a lease between the SNLL tenants and a third-party landlord, along with a Payment Direction Deed between the landlord, the SNLL tenants and Sterling Corporate Services Pty Ltd.

Annexure C is an example of a "Silverlink type" of SNLL, in which the third-party landlord entered into a headlease with Sterling Corporate Services Pty Ltd under which market rent was payable, along with a sublease between Sterling Corporate Services Pty Ltd and the SNLL tenant, under which no or nominal rent was payable.

The complexity of the offering resulted in two different regulatory bodies having jurisdiction in relation to different aspects of the offering. The Sterling New Life Lease arrangement was regulated by DMIRS, as the regulator responsible for the licensing and supervision of real estate agents and laws in relation to residential tenancies. The Sterling Income Trust and the Silverlink redeemable preference share issue were regulated by ASIC. To the extent that there was overlap, ASIC has worked alongside and liaised closely with DMIRS to take action against the Sterling Group.

6. What outreach did ASIC make to complainants and investors?

As part of our investigations into the Sterling Group ASIC has met with or spoken to 44 tenant-investors to discuss their experiences, as well as conducting face to face interviews with a further four individuals who were SNLL tenants and/or investors in Silverlink, as noted in paragraphs [143] and [166] of the ASIC submission, in December 2018.

ASIC has had further engagement with other investors during the course of its investigations, including in relation to the brief of evidence prepared for the Commonwealth Director of Public Prosecutions (**CDPP**).

Since the appointment of voluntary administrators to the Sterling Group, ASIC has directed investors and complainants at first instance to the voluntary administrators and to AFCA. The voluntary administrators had direct access to the Sterling Group's books and records and were able to advise on individual investors' and tenants' circumstances. AFCA is empowered by legislation to provide independent external dispute resolution and is able to handle individual complaints.

ASIC has also engaged in high-level advocacy on behalf of affected complainants in investors. ASIC has made representations to AFCA regarding expediting applications for compensation for Sterling investors. We have liaised with lawyers who are acting pro bono for several elderly investors. ASIC has also cooperated, liaised with, and provided funding to the administrators of the Sterling Group, namely Ferrier Hodgson (and later KPMG after the Ferrier/KPMG merger). ASIC has engaged at an executive level with Macquarie Bank and obtained its agreement to provide assistance in the form of an advice line to vulnerable investors and Sterling New Life tenants through its vulnerable client team.

7. How many different Sterling related products were reported to ASIC and how many were investigated?

The following Sterling related products were reported to ASIC, and ASIC made inquiries in relation to each of these products:

1. Sterling Residential Development Syndicate (Aust) Pty Ltd, a property development scheme;

2. Sterling Income Trust and the four underlying asset classes corresponding to sub-trusts of the Sterling Income Trust;

3. Silverlink redeemable preference share offering; and

4. The Sterling New Life lease product, which was coupled with investments in the Sterling Income Trust or redeemable preference shares in Silverlink.

8. Please outline how ASIC identified that there was a risk to investors' money and what was done about it?

ASIC's involvement with the Sterling Group and Sterling Income Trust, including how it identified there was a risk to investors' money and its regulatory response, is set out in considerable detail in paragraphs [142] – [202] of the ASIC submission.

9. Please identify when ASIC identified and investigated other breaches by the Sterling group (including directors) of the law or regulations?

ASIC's investigation of the Sterling Group, including ASIC's identification and investigation of breaches of law by the Sterling Group is described in detail at paragraphs [142]-[202] of the ASIC submission.

10. In 2017 and 2018, ASIC personnel contacted many of the Sterling tenants. What prompted this contact, what was the nature of the information collected and how was this used prior to the release of the stop order?

The contact was prompted by ASIC commencing a formal investigation on 29 May 2018 as to whether members of the Sterling Group had contravened ss 601FC, 601FD, 727, 911A, 1018A, 1041E and 1041H of the *Corporations Act* and ss 12DA and 12DB of the *ASIC Act* (as set out in ASIC's written submission at [165]). The contact was part of ASIC's information-gathering process in support of the formal investigation.

In June and July 2018, ASIC conducted interviews with Sterling New Life tenant-investors who had invested in the Sterling Income Trust. These interviews were conducted at an early stage of the investigation with a view to understanding the nature of the dealings between the Sterling Group and tenant-investors.

These questions included, but were not limited to:

- How they were introduced to or became aware of Sterling (for example, whether by a newspaper ad or attending a seminar);

- How much money they invested;

- Whether they knew they were making a financial investment into the Sterling Income Trust;

- What documents they were given prior to signing the lease, and whether they read and understand those documents

- Whether they were told to get independent legal, accounting and financial advice

- Whether they were told or made to understand that if they wanted to leave the lease they could get their full investment/capital back; and if so, who told them that

- Whether they were aware or told that there was any risk or potential they could lose all of your capital/investment in the Sterling Income Trust

The responses to these questions enabled ASIC to define the scope of the investigation and efficiently allocate its resources.

In December 2018, ASIC was contacted by Tenancy WA regarding complaints from four individuals who were SNLL tenants and/or investors in Silverlink. ASIC sought to interview the affected tenant-investors to ascertain the nature of their dealings with the Sterling Group.

These interviews provided ASIC with invaluable detailed information which again guided ASIC's investigation, including the investigation of aspects of the matter which are now the subject of ASIC's brief to the CDPP.

11. Please provide copies of the correspondence sent to complainants regarding advice from ASIC as to what actions they should take in response to their complaints

ASIC has received a large volume of consumer correspondence and complaints.

In **Annexure D** is an example of ASIC's correspondence to SNLL tenant-investors in August 2019. We also attach a copy of information provided to tenant-investors on our website over the last 3 years.

12. When was ASIC aware that the draft laws for the compensation scheme of last resort excluded managed investment schemes?

ASIC has been aware that the draft laws for the compensation scheme of last resort did not include managed investment schemes since it was first proposed in September 2017. The legislation that was introduced into Parliament by the Government on 28 October 2021, in line with the Ramsay Review recommendation, does not cover managed investment schemes. However, the design, scope and funding arrangements for the compensation scheme of last resort (**CSLR**) are ultimately matters for the Government and not for ASIC.

13. Have there been limitations with ASIC's legal and regulatory powers in terms of investigating or taking action on this case?

ASIC's role in regulating managed investment schemes such as the Sterling Income Trust is described at paragraphs [125]-[141] of the ASIC submission. In particular, ASIC notes that Australia's financial regulatory system generally does not involve "merit" regulation of financial products. ASIC in its written submissions has also identified certain law reform proposals which may be of assistance in relation to regulating managed investment schemes, particularly in relation to insolvent schemes: paragraphs [224]-[240].

ASIC also notes in its submission that two significant new recent law reforms were not in force at the time of the Sterling collapse, being the product intervention powers and the design and distribution obligations: paragraphs [224]-[236].

In addition to the matters set out in the written submission, ASIC notes:

a. One significant aspect of ASIC's work is the requirement to obtain evidence prior to taking various regulatory steps. While ASIC does not see this as a "limitation", the requirement of gathering evidence in order, for example, to support applications for court orders in respect of regulated entities, may result in perceptions of delay when considered in hindsight.

b. Another aspect of ASIC's work is the requirement to provide procedural fairness to persons affected by ASIC's work. For example, under the legislation, ASIC cannot issue a final stop order in respect of a PDS without holding an administrative hearing where interested parties are given the opportunity to make submissions as to whether the final stop order should be made. This reflects the fact that ASIC's regulatory and enforcement actions will often affect the rights and interests of parties other than ordinary consumers, sometimes including legitimate businesses, and that these persons also have a right to be involved and treated fairly in the process.

c. Finally, one relevant but not overriding consideration in relation to ASIC's decisions to take action in relation to the Sterling Group is whether such actions would deliver a financial return to Sterling Group's investors and tenants. As an example, ASIC has made inquiries as to the assets held by directors and related persons in the Sterling Group and that has played a role in ASIC's decisions regarding enforcement actions.

14. Was ASIC aware of concerns to do with Sterling and associated companies that they were unable to act on because of any limitations of regulatory powers? If so, were these concerns reported to in terms of being able to make other regulators aware of what was wrong and what was happening? Have any limitations been addressed since?

As noted above in ASIC's response to Question 5, the Sterling Group's activities included residential tenancy products which are regulated under State legislation and over which ASIC does not have jurisdiction. ASIC has worked collaboratively with the relevant agency, DMIRS, in relation to tenancy and real estate aspects of the Sterling Group's activities.

Under the statutory framework, AFCA has jurisdiction to determine or deal with individual customers' complaints against financial firms. For this reason, ASIC has referred individual applications to AFCA for determination.

Otherwise, ASIC refers to its response to Question 13.

15. Please detail all of the court cases and outcomes ASIC has been involved in regarding the Sterling Group. In cases when the investors lost, please provide the final findings.

On 11 December 2019, ASIC commenced an action in the Federal Court in Western Australia (file number WAD 613/2019) against Theta Asset Management Limited (**Theta**), the responsible entity of Sterling Income Trust, and Robert Marie, the director of Theta. As set out at paragraphs [115]-[117] of ASIC's written submissions, ASIC alleged that Theta and Mr Marie failed to ensure that five product disclosure statements (**PDS**) for the Sterling Income Trust were not defective. ASIC alleged the PDSs were defective in containing misleading or deceptive statements and omissions in respect to statements and information required to be disclosed.

The Federal Court ultimately ordered Theta to pay a penalty of $2,000,000 with respect to the declarations of contravention and ordered Mr Marie to pay a penalty of $100,000: *Australian Securities and Investments Commission v Theta Asset Management Limited* [2020] FCA 1894. Mr Marie was also disqualified for four years from managing corporations.

On 15 October 2021, ASIC referred a brief to the CDPP for consideration. The contents of that brief are confidential.

16. Which powers in the Corporations Act have been exercised in this case?

Powers in the Corporations Act that ASIC has exercised in this case include powers under:

- Section 206C of the Act, which allows ASIC to apply to the court for a director (here Robert Marie) to be disqualified;
- Section 912C of the Act, by issuing a notice of direction to a financial services licensee to provide a written statement about certain matters, to assist in ASIC's investigation;
- Sections 920A and 920B of the Act, by issuing an administrative banning order against Robert Marie prohibiting Mr Marie from providing any financial services for a period of four years;
- Section 1020E(2) of the Act, which allows ASIC to make final stop orders in relation to a product disclosure statement – this was issued on 29 August 2017 in respect of the Sterling Group PDSs; and
- Section 1020E(5) of the Act, which allows ASIC to make interim stop orders in relation to a product disclosure statement – this was issued on 9 August 2017 in respect of the Sterling Group PDSs.

ASIC also used the prospect of an application for the appointment of provisional liquidators to the Sterling Group pursuant to s 472(2) of the Act in the discussions with the directors of Sterling Group. Those discussions ultimately resulted in the directors of Sterling Group appointing voluntary administrators to the Group.

The liquidators of the Sterling Group have (among other things) exercised their powers under s 533(2) of the Act to lodge reports specifying matters that they think are desirable to bring to the notice of ASIC.

The Federal Court exercised its powers under s 1317E in making declarations regarding Theta and Robert Marie in the civil penalty proceeding brought by ASIC and its powers under s 1317G of the Act in ordering Theta and Robert Marie to pay pecuniary penalties to the Commonwealth.

17. Was ASIC involved in advising, discussing or consulting with the Sterling group as to the content of any of their PDSs prior to their publication? If so, on how many occasions did this occur and who were involved with these discussions?

ASIC made non-exhaustive comments on the content of a draft Sterling Income Trust PDS on one occasion on 22 September 2017. The comments identified several concerns ASIC had with the draft PDS. At no point has ASIC "approved" or "endorsed" a Sterling Group PDS.

Due to the concerns that this issue has raised and in order to provide clarity to the Senate, ASIC provides the following context:

1. On 9 August 2017, ASIC issued an interim stop order in respect of all then current Sterling Income Trust PDSs. Following this, under s 1020E(4) of the Act, ASIC was required to give Theta an opportunity to be heard in deciding whether a final stop order should be made. That opportunity is given at an administrative hearing before a delegate of ASIC.

   As part of this process, to discharge ASIC's duty to give a "reasonable opportunity" for Theta as an interested person to make submissions to ASIC on whether the final stop order should be made, ASIC provided Theta with a "Statement of Concerns" alongside the interim stop order on 9 August 2017. The Statement of Concerns set out ASIC's concerns in relation to the PDS and the grounds on which ASIC had formed the view that the PDSs were defective. This is in line with ASIC's usual practice and procedure in relation to interim stop orders and is required by the Act.

2. On 10 August 2017, Theta acknowledged the interim stop order, indicated it would not attend the administrative hearing on 28 August 2017 and notified ASIC that it would no longer issue interests in Development Units and Management Company Units, but that it would be preparing a new PDS for Income and Growth Units. An ASIC officer spoke with Theta's solicitor on 11 August 2017. The solicitor informed ASIC that Theta would provide it with a draft PDS for the Income and Growth Units. On that occasion and on subsequent occasions, ASIC confirmed that ASIC does not review or endorse draft PDSs.

3. On 31 August 2017, after the issue of the final stop order on 29 August 2017 and after ASIC ensured that two Sterling Income Trust seminars had been cancelled, Theta provided ASIC a copy of the new draft PDS and a covering letter which outlined the changes to the PDS and how, in its view, ASIC's concerns set out in the Statement of Concern were addressed. On the same day, ASIC confirmed receipt.

4. On 19 September 2017, Theta's solicitor requested an update on the draft PDS provided on 31 August 2017. The ASIC lawyer responded the next day, noting ASIC was aiming to provide some preliminary comments on the draft PDS by the end of the week. The ASIC lawyer reiterated that ASIC does not pre-vet or approve PDSs and it is necessary for Theta to ensure the PDS complies with the Corporations Act.

5. On 21 September 2017, Theta's solicitor responded to the ASIC lawyer, and stated that her firm had reviewed the proposed changes to the draft PDS. The solicitor also outlined in detail the due diligence process which Theta would undertake in relation to the draft PDS.

6. On 22 September 2017, the ASIC lawyer provided comments on the draft PDS. The covering email expressly stated that:

   a. the comments were not exhaustive and that it was necessary for Theta to ensure that the PDS complied with Corporations Act requirements;

   b. ASIC does not pre-vet or approve PDSs;

c. Theta should review and revise the PDS to ensure compliance with the Corporations Act; and

d. ASIC did not propose to undertake any further review of the draft PDS;

e. Theta may wish to consider seeking legal advice on the content of the draft PDS; and

f. ASIC reserved the right to take action if ASIC considered it appropriate, necessary or in the public interest to do so.

This was the last contact ASIC and Theta had in relation to the draft PDS prior to its issue on 27 October 2017.

18. Was the Silverlink vehicle being used to raise funds for over 9 months (approximately $11 million) without a PDS after the stop order had been issued against the Sterling Income Trust? When and how did ASIC become aware of this?

Yes, funds were raised by offering redeemable preference shares in SilverLink Investment Company Limited and Silver Link Securities Limited (together, Silverlink) from around December 2017 to December 2018 (although funds received were initially received into the Sterling Corporate Services bank account before being transferred to Silverlink Investment Company in February 2018).

On 13 April 2018, ASIC was provided with material by DMIRS that indicated Sterling had begun promoting investment through preference shares in SilverLink Investment Company Limited without a current prospectus.

On 22 June 2018, after ASIC advised Sterling that any such offering would be unlawful, Sterling advised ASIC through its external solicitor (a partner of a national law firm) that the offering had been removed from the website in May 2018, and ASIC took steps to confirm that it had been removed.

It was only on 4 December 2018 that ASIC became aware from a referral from Tenancy WA that Sterling had nevertheless proceeded to raise funds through the offer of investments in Silverlink. ASIC then took action to obtain formal written undertakings from the Directors of Silverlink to cease accepting funds for Silverlink investments. Aspects of this conduct have been referred to the CDPP for the CDPP's consideration.

Further details of ASIC's response is set out at paragraphs [171] – [202] of the ASIC submission.

19. Was ASIC aware of several directors who had been involved in previous financial schemes that had collapsed? If yes, when and what did ASIC know?

As part of the standard consideration of any reports of misconduct or complaints, searches were conducted in relation to the directors of the entities referred to in the reports. This would have included searches of the names Brian Ruzich, Ryan Jones, Simon Bell (as directors of Sterling Group companies) and Robert Marie (as director of Theta). Prior to the orders made in the civil penalty proceedings brought by ASIC against Robert Marie in the Federal Court in Western Australia, none of those persons were subject to disqualification from managing corporations under ss 206A to 206G of the *Corporations Act*.

20. What role does ASIC have in informing and protecting consumers from investing in financial schemes that are associated with directors/individuals that have been involved in previous schemes that have collapsed?

Under s 601EB of the Act, ASIC *must* register a managed investment scheme unless ASIC is not satisfied of certain matters. None of these matters relate to the character, history, or reputation of the organisers, promoters or related persons to the managed investment scheme.

Under s 913B of the Act, ASIC *must* grant an AFS licence to someone who applies for the licence if, among other things:

- ASIC has no reason to believe that the applicant is likely to contravene the obligations under s 912A if the licence is granted; and
- The fit and proper person test under s 913BA is satisfied in that there is no reason to believe that the *applicant* or its responsible officers is not a fit and proper person to perform one or more functions in providing the financial services covered by the licence.

Importantly, the 'no reason to believe' test requires actual evidence the applicant has been involved in illegal activity and not just mere suspicion.

ASIC notes that Simon Bell and Ray Jones were not officers of the relevant Australian Financial Services Licensee (Theta), and so the above test was not enlivened when ASIC granted an AFSL to Theta.

To inform and protect consumers, ASIC publishes media releases on its website which detail actions ASIC takes against financial firms and individuals, including disqualification orders and banning orders. However, for legal reasons, ASIC cannot "name and shame" directors or individuals for the sole reason that they were involved in previous schemes that have collapsed. Schemes may collapse for a variety of reasons, including where there has been no wrongdoing by the directors or individuals.

The directors of each company registered in Australia is a matter of public record and can be searched on the ASIC website or via an information broker.

21. What powers does ASIC have to prevent financial schemes with relatively high risk of failure being offered in the first place?

Under the financial services regulatory regime in Australia, high risk financial products are permitted (see paragraph [19] of the ASIC Submission). That is, there is no general prohibition on selling high risk investment products to Australian consumers.

The design and distribution obligations (that commenced in October 2021) provide ASIC with additional power to ensure that a product has a sensible target market and is being sold to that target market. The obligations require a responsible entity to define a target market and effectively ensure the product will likely be consistent with the likely objectives, financial situation and needs of the consumers in that defined group.

Where a product is marketed and sold to a large number of consumers for whom the product is not appropriate then there is likely to be a breach of the design and distribution obligations. In such circumstances, ASIC may impose a stop order on further sales of the product until the design and distribution issues are resolved.

However, there is no prohibition on having a target market of consumers seeking high returns and with a high tolerance for risk, and designing a product for that target market.

As discussed above in our answer to Question 20, ASIC has obligations to grant AFS licences and to register schemes when a properly compliant application is made. As such, there is limited scope for ASIC to entirely prevent high-risk products from being offered. It is also worth noting that ASIC's regulatory role does not involve preventing all consumer losses or ensuring compensation for consumers in all instances where losses arise. That would be contrary to the free-market and disclosure-based system in Australia.