Committee	Senate Economics References Committee
Inquiry	Inquiry into Sterling Income Trust
Question No.	001
Reference	Spoken, 16 November 2021, Hansard page 9
Committee member	Senator Scarr

Question

Senator SCARR: In my mind, I'm drawing a distinction. On the one hand, there's the regulator seeing a PDS which doesn't dot the i's and cross the t's and saying, 'You need to tweak your disclosure around'—x and y—or 'There's this complication that needs to be beefed up.' There's that sort of amendment to a PDS. But, to me, this falls into another category. I haven't seen the PDS and the detail of what was lacking in the PDS. Maybe you could take that on notice, to give me a better feel for how it was lacking.

Mr Longo: We can definitely do that.

Answer

1. What was lacking or defective in the earlier PDSs?

As set out in our Submission, we are not a merits regulator (see paragraph 16). We dealt with the PDSs before us in relation to the Sterling Income Trust.

ASIC had a number of concerns about the three PDS in use in mid-2017. We attach the statement of concerns issued to Theta together with the interim stop order (see **annexure**). The stop orders were based on the following concerns:

- Income Units & Growth Units PDS
    - Omission to fully and clearly disclosure extent and effect of the related party transactions and conflicts of interests
    - Omission of information about significant risks
    - Misleading disclosure and omissions relating to the Sterling Income Support Agreement
    - Misleading disclosure and omissions relating to Target Returns
    - Material on Income Units may be misleading and is not presented in a clear, concise and effective manner
    - Material on Growth Units may be misleading and is not presented in a clear, concise and effective manner
    - Material on Financial Information may be misleading
    - Disclosure about related party transactions and conflicts of interests are not presented in a clear, concise and effective manner
- Management Company Units PDS
    - Disclosure about related party transactions and conflicts of interests are not presented in a clear, concise and effective manner

  - Omission of information about significant risks
  - Omission of Financial Information
  - Omission of information about Sterling First
  - Misleading references to redemption
  - Omission of information and misleading statements about Stirling New Life Leases
- Development Units PDS
  - Omission to fully and clearly disclose extent and effect of the related party transactions and conflicts of interests
  - Omission of information about significant risks
  - References to Target Returns
  - Omission of information about loans
  - Misleading references to Stirling New Life Leases

To form these views, we needed to collect information and evidence, and analyse the documents. This necessarily took some time.

The law requires the product issuer to ensure that the PDS is complaint. Given ASIC is not a merits regulator it is not for ASIC to determine whether or not it is possible for a product issuer to prepare a compliant PDS for a particular product. The law does not ban risky products – provided that proper disclosure is given, the product would be able to be sold.

ASIC imposed a stop order in relation to the then current PDSs in mid-2017 and published a media release announcing the stop order. It was then for the product issuer (Theta) to review the situation with its lawyers and work out what to do next – whether to modify the product, prepare a properly compliant PDS or close the product. In the end, they decided to prepare a new PDS, as they were entitled to do.

ASIC did not and does not approve PDSs. It was Theta's responsibility to ensure the PDS they prepared was adequate.

2. Should ASIC have taken different or stronger action because of the PDS deficiencies?

a. The August 2017 stop order

The overall timeline is set out on page 31 of the Submission.

In light of the situation facing tenant-investors and the material available to ASIC as at March – August 2017, ASIC's view was that the issue of stop orders over the Sterling Income Trust PDSs would be the fastest and most effective way for ASIC to protect potential future tenant-investors. ASIC acted reasonably promptly to obtain the evidence and grounds necessary for stop orders, which were issued on 9 August 2017.

In our view, a stop order was the most efficient and timely approach to prevent further sales of interests in the Sterling Income Trust unless and until the disclosure issues were resolved. This is a power ASIC can itself exercise, and does not involve an application to the court. In our view, a court injunction to stop further sales would not have been any quicker.

An application for an injunction also requires ASIC to prepare and the court to consider evidence and submissions from the parties. Although the questions whether there is a serious question to be tried and where the balance of convenience lies will not circumscribe the court's consideration in an application for an interim injunction under s 1324(4), the interests of justice will always require that those questions be examined carefully when restrictions are sought to be imposed before the case has been properly examined by the court, even where the protection of the public is said to be involved: see per Young J (as his Honour then was), in Corporate Affairs Commission (NSW) v Lombard Nash International Pty Ltd (1986) 11 ACLR 566.

Injunctions would have required the necessary and admissible supporting evidence that we simply did not have at the time. Restrictions on a company that a party seeks to impose before a court has properly examined a case will always require careful consideration on whether there is a serious question to be tried.

For this reason, and because at the time ASIC was becoming concerned that the scheme may actually be insolvent, in early 2018 ASIC focused on gathering enough evidence to take action against Theta as the responsible entity to close the scheme down. We remain of the view this was the right thing to prioritise at the time in this matter and in view of the other enforcement matters that ASIC was also undertaking at that time.

We did not, at this time, have any complaints from tenant-investors who were unhappy with their tenancy or investment or evidence of investor losses. At that time, key aspects of the SNLL arrangement later found to be problematic (e.g. the non-recourse arrangement in the Payment Direction Deed) in the later Supreme Court case, had not yet come to light.

In taking injunctive action, ASIC needs to cautious not to precipitate investor losses where investor outcomes may still be uncertain.

"Appointment of a receiver over a person's assets is in any circumstances an extraordinary step for the court to take, though it may be justified when associated with the allegation of misappropriation of property, particularly, though not necessarily exclusively, fraudulent." (Australian Securities and Investments Commission v Adler (2001) 38 ACSR 26).

In short, broadly speaking, seeking interim injunctions or the appointment of receivers or liquidators in the period after March 2017 would have been unlikely to succeed.

We undertook telephone interviews with at least 44 tenant-investors during this time, to better understand how they had entered into the SNLL arrangement and what they understood of it. We attach a copy of the script and interview guide used by the ASIC team for these interviews [**see annexure**].

<u>What requirements must ASIC satisfy before issuing a stop order?</u>

ASIC cannot simply issue a stop order immediately based on a suspicion or a report of misconduct alone. Under the law, ASIC must have good grounds for issuing a stop order, and must provide procedural fairness to affected persons (here, Theta and Sterling Income Trust) prior to the issue of a final stop order. An interim stop order can generally only last for 21 days before a final stop order must be made. As a result, ASIC must have gathered

sufficient evidence and articulated its grounds for the stop order prior to the issue of even an interim stop order.

Under the law, before issuing a final stop order, ASIC must hold an administrative hearing and give a reasonable opportunity for any interested persons to make verbal or written submissions to ASIC on whether the final stop order should be made. The hearings must be conducted in accordance with general principles of procedural fairness, such as where the decision maker has an open and impartial mind, and where findings of fact are made on a sound basis.

These requirements reflect the policy that ASIC should not be able to intervene to stop businesses' operations without having good grounds for doing so and after having provided procedural fairness to those businesses. ASIC action, including stop orders, can have devastating effects on businesses. While in this case Sterling Income Trust has proven to cause devastating losses for investor-tenants, ASIC must proceed on the basis that not all of the businesses which it investigates are in breach of the law.

For these reasons, it is critical for ASIC to thoroughly investigate each report of misconduct and ensure it has credible evidence prior to issuing a stop order (or indeed prior to taking any compliance or enforcement action).

What steps did ASIC take before issuing stop orders in relation to Sterling Income Trust?

Between 27 March 2017 and the issue of the interim stop order on 9 August 2017, ASIC reviewed the materials provided by DMIRS. ASIC also obtained and reviewed further materials including obtaining and reviewing PDSs which were not publicly available. ASIC had numerous discussions with DMIRS and undertook surveillance of Sterling Income Trust activities. On 9 August 2017, having gathered the necessary evidence and persuaded an impartial ASIC delegate that an interim stop order was necessary, ASIC issued an interim stop order. Theta acknowledged the interim stop order on 10 August 2017, and ASIC also notified DMIRS of the interim stop order and asked it to contact ASIC if they became aware of any new investors in the Sterling Income Trust.

ASIC then had 21 days to obtain a final stop order, including after holding an administrative hearing outlined above. Following further investigations, including stopping a Sterling seminar scheduled for 21 August 2017, ASIC issued a final stop order on 29 August 2017 and subsequently published a media release publicly announcing the stop order. Theta had at that point consented to the final stop order. The effect of the stop orders was that any offers, issues, sales or transfers of the interests in the Sterling Income Trust under the PDSs were prohibited while the final stop order remained in force.

b. the replacement PDS

First, it is important to note that ASIC did not endorse or otherwise approve the PDS issued by Theta on 27 October 2017 (the replacement PDS). This is discussed in further detail at ASIC's response to Senator Pratt's QoN no 17, which sets out the circumstances in which ASIC provided comments on a draft PDS on 22 September 2017, prior to its issue on 27 October 2017. Those comments were expressly stated to be not exhaustive, and subject to

Theta's obligations to ensure that the PDS complied with Corporations Act requirements. ASIC reserved its right to take action if required.

Theta engaged with ASIC and Theta took steps to correct the PDS. Theta was represented by reputable solicitors who were closely engaged with the process. Those solicitors also provided assurances to ASIC regarding Theta's due diligence process. ASIC provided its 22 September 2017 comments on the basis that they were not exhaustive and that Theta had the responsibility of ensuring that any revised PDS was compliant.

The adequacy or otherwise of a PDS can be a complex question. Consideration of the broader context and underlying documents is required. ASIC has to request a PDS it wishes to review, as they are not lodged with us – and sometimes we need issue notices to obtain them. The complexity of the issues pertaining to the PDS is demonstrated by the detailed judgment in ASIC v Theta Asset Management Limited [2020] FCA 1894 regarding the Sterling Income Trust PDSs.

ASIC's broader focus at that time was the solvency of the Sterling Income Trust, having received Theta's audited financial statements on 29 September 2017 which raised a "material uncertainty" over the Sterling Income Trust's ability to continue as a going concern. ASIC took proactive steps in respect of these issues and on 30 April 2018 Theta closed the Sterling Income Trust to new investors and informed ASIC that the Second PDS was no longer in use.

Otherwise, we refer to our answer to Question Notice 17 provided to Senator Pratt on 15 November in respect of the comments provided by ASIC to Theta in respect of the revised PDS on 22 September 2017.

c. The Silverlink fundraising

Based on ASIC's further investigations in relation to suspected criminal conduct, ASIC believes that the Sterling Group actively concealed from ASIC fundraising through Silverlink companies. On 13 April 2018, ASIC was made aware by DMIRS that the Sterling Group had begun to promote preference shares in two Sterling Group companies, SilverLink Investment Company Limited and Silver Link Securities Limited (together, Silverlink).

At that time, ASIC's view was that it did not have sufficient evidence to challenge the Sterling Group's promotion of the issue of shares in Silverlink. Between April 2018 and June 2018, ASIC took steps to obtain and consider evidence against Silverlink and the Sterling Group in respect of the Silverlink investment and in the context of ASIC's broader investigation against the Sterling Group. These steps included obtaining and considering information and documents from DMIRS and other sources (including under a section 33 Notice served on DMIRS on 6 June 2018).

This investigation culminated in a meeting on 22 June 2018 with Robert Marie (director of Theta), Ray Jones (director of some Sterling Group entities, including Silverlink) and their solicitor, who was a partner of a national law firm.

At the meeting, ASIC advised Sterling that the new Silverlink offering on the website appeared to be illegal in circumstances where there was no prospectus and Silverlink was

not an AFSL holder. The law firm partner confirmed that that Silverlink investment option had been removed from the Sterling Group website on 18 May 2018. Mr Jones, a director of Silverlink, conceded it should never have been on the website because there was no prospectus and Silverlink was not an AFSL holder. Following the meeting, ASIC took steps to confirm that removal from the website had occurred.

In the days following this meeting, Sterling expressed its intention to shut down the Sterling Income Trust MIS. On 2 July 2018, Sterling sent a letter to SNL investor-tenants which gave an undertaking to fully remediate investor-tenants if they wanted to terminate their Sterling New Life Lease [see **annexure**]. ASIC obtained that letter on 4 July 2018. The letter was addressed to "Sterling New Life Tenant's" generally, but ASIC later learned that it had not been sent to Silverlink investors. Further, in late June 2018, Sterling's communications with ASIC omitted the Silverlink tenant-investors from a list of Sterling New Life Lessees.

In its further investigations, ASIC has since obtained an email dated 24 July 2018 which was sent internally to a SNLL sales representative which specifically referred to concealing Silverlink from ASIC.

On 4 December 2018, ASIC received a referral from Tenancy WA that Sterling had nevertheless proceeded to raise funds through the offer of investments in Silverlink. Upon becoming aware of this information ASIC quickly took action to obtain formal written undertakings from the directors of Silverlink to cease accepting funds for Silverlink investments. This was obtained on 17 December 2018, less than two weeks after ASIC received the further intelligence from Tenancy WA.

Aspects of the above conduct have been referred to the CDPP for the CDPP's consideration. Further details of ASIC's response in December 2018 are set out at paragraphs [171]-[202] of the ASIC submission.

Annexures

1. Copy of ASIC statement of concerns sent to Theta Asset Management, 9 August 2017.

2. "Investors questions" – ASIC interview guide, June 2018.

3. Letter from Sterling Group to SNLL tenant-investors, 2 July 2018.

Committee	Senate Economics References Committee
Inquiry	Inquiry into Sterling Income Trust
Question No.	002
Reference	Spoken, 16 November 2021, Hansard page 11
Committee member	Senator O'Neill

Question

ACTING CHAIR: Yes, the ones on notice. Commissioner Armour, you said a professional entity. In what profession?
Ms Armour: Theta conducted the business, effectively, of being a responsible entity for various managed investment schemes. So it wasn't an entity that was part of the Sterling Group of companies.
ACTING CHAIR: And what was the profession of the people in that professional entity? What was their skill set?
Ms Armour: Their skill set was to run a managed investment scheme. That was effectively their skill set.
ACTING CHAIR: Were they lawyers or were they accountants or were they people with financial—
Ms Armour: We can certainly get back to you with more details on that.

Answer

The reference to Theta being a "professional entity" refers to the fact that Theta was the responsible entity for multiple funds across multiple unrelated investment managers (sometimes known as a 'an RE for hire'). Theta Asset Management's managing director was Mr Robert Marie. Theta received its AFS licence in May 1996. The qualifications and background of the relevant responsible officers would have been checked at the time.

Based on our records, Mr Marie's qualifications were a Bachelor of Commerce from UNSW. He was a member of a number of professional and industry bodies. At the time of the Sterling collapse, he had worked in the financial services industry for approximately 30 years.

Committee	Senate Economics References Committee
Inquiry	Inquiry into Sterling Income Trust
Question No.	003
Reference	Spoken, 16 November 2021, Hansard page 12
Committee member	Senator O'Neill

Question

ACTING CHAIR: I'm coming to you, Senator Scarr. I'll put a couple on notice myself. In your opening statement you indicated that the UK, the EU and, as we've heard in previous hearings, the US have a different regime around product disclosure, one that is more aligned with Australia's understanding of consumer affairs. People understand the purchase of a physical good is something that they need to be careful about but they have a certainty degree of a sense of protection provided by the government. With financial products, Australians are subject to, as they've written: 'financial dealings must be governed by the principle of caveat emptor—Latin for buyer beware—and the Prime Minister himself and the Treasurer agreed with the chair of APRA, Wayne Byers, when he described that: "And that is our reality."' On notice, if this scheme was established in the UK, the EU or the US, what would its fate have been and at what point, just so I can understand the comparator with another jurisdiction, because a lot of the materials that have come before us are saying things like ASIC are keeping buyers in the dark, they're not taking action and not identifying that these companies have scams. People think that as soon as it's been registered with ASIC there's a process of assessment. That's the reason I ask for it. There's a doesn't exist a tick like the heart tick, and that people are anxious about. What policy response is required so that what's happened to these victims—

Mr Longo: It's a very good question. There's a total mismatch of understanding and expectations between what ASIC does at that point of registering the scheme and what's going on in the minds of some people, consumers, about what they think ASIC is doing. We're quite happy to go into that in more detail.

Answer

Broadly speaking, a "collective investment fund" and "mutual funds" are the UK and US equivalents to Australian "managed investment funds". Each of the jurisdictions identified has restrictions that collective investment schemes or mutual funds must abide by where they are being offered to retail investors. Retail investors are generally non-professional or individual investors.

If such restrictions were applicable in Australia at the relevant period, this would likely have resulted in the Sterling Income Trust not being available to retail investors.

For example, Undertakings for the Collective Investment in Transferable Securities (UCITS) (offered in the EU and UK) are subject to restrictions on the type of assets that can be invested in and also portfolio diversification requirements. UCITS must only invest in certain securities traded on a market, certain money market instruments and derivatives (subject to certain risk limitations).

Further, there would need to be some portfolio diversification such as limits on the percentage of assets permitted to be invested in a single issuer or group of issuers.

There are similar restrictions on mutual funds in the US around the types of investments mutual funds can hold including a requirement the fund must value all their portfolio holdings on a daily basis, based on market values if readily available, a requirement that at least 85 percent of a mutual fund's portfolio must be invested in "liquid securities," which are defined as any assets that can be disposed of within seven days at a price approximating market value, limitations on leverage and a requirement under federal tax laws to be, among other things, diversified (generally speaking, with respect to half of the fund's assets, no more than 5 percent may be invested in the securities of any one issuer; with respect to the other half, the limit is 25 percent).

If policymakers are minded to consider reform to avoid investment in registered managed investment schemes that are more likely to cause retail investors harm there would be value in giving consideration to the requirements in other well respected jurisdictions.

ASIC notes that schemes passported under the Asia Region Funds Passport (to which Australia is a signatory) have to comply with a range of investment restrictions similar to UCITs in the EU before being able to be offered to retail investors under the passporting arrangements, see: Asia Region Funds Passport | ASIC - Australian Securities and Investments Commission. Similar arrangements could be considered in the context of registered managed investment schemes outside the passporting arrangements.

Committee	Senate Economics References Committee
Inquiry	Inquiry into Sterling Income Trust
Question No.	004
Reference	Spoken, 16 November 2021, Hansard page 12
Committee member	Senator O'Neill

ACTING CHAIR: That would be great. Could you also taken on notice how what's happened with Sterling would interact with any establishment of a system of identification of beneficial ownership, what you think having directorate information numbers would have done in terms of interrupting what happened with Sterling? I'm keen to milk it for as much information as I can. If people aren't going to get their money back, as you indicated, then they're suffering. They ask that this doesn't happen to another Australian. That's what they ask for.

Mr Longo: That goes to the heart of it. We have been thinking very carefully about what the lessons learned are from this situation, and, with respect, we'll do our very best to figure out what those lessons are.

ACTING CHAIR: And provide that to the committee, and any advice you might have given to government. Senator Scarr, you have a question you wanted to put on notice?

Answer

Being involved in an unsuccessful business or even (for example) a business which has left significant unpaid creditors does not mean that ASIC can automatically stop a person from being involved in another business. The circumstances in which a person can be disqualified from managing corporations are set out at sections 206A to 206G of the Corporations Act. They include having certain criminal convictions or being an undischarged bankrupt.

If someone is not subject to any of the disqualification provisions under the Corporations Act, and there is no court order banning them from being a director, then ASIC cannot of its own accord prevent them from being involved in another business, including as a director. This reflects the public policy of the Corporations Act that people should be able to take risks in their businesses and sometimes fail, and a business failure does not necessarily mean they should never be allowed to run a business again.

The law sets out specific consequences for persons becoming bankrupt – for example, a person cannot be a director, alternate director or secretary while they are in bankruptcy. However, once their bankruptcy is discharged – usually around three years after the bankruptcy – then under the law, that limitation no longer applies. ASIC must exercise its powers within the boundaries of the law.

The Sterling Income Trust was registered with ASIC by its trustee, Theta Asset Management. In doing so, Theta became the responsible entity of the Sterling Income Trust. As far as ASIC is aware, Mr Bell and Mr Jones had no role in relation to Theta and were not mentioned in any of the registration documentation for the Sterling Income Trust. However, even if they had been

mentioned in any of this documentation, it would not have been a ground under the Act to refuse to register the scheme.

The Australian company registration system merely records the registration of directors and their personal details. In December 2016, there were more than 2.4 million registered companies in Australia. It was not feasible for ASIC to check the details of every person who registered as a director in Australia. There is an obligation on the person providing information to ASIC to ensure that those details are true and correct.

From November 2021, company directors will need to verify their identity as part of a new director identification number requirement. A director ID is a unique identifier that a director will apply for once and keep forever, which will help prevent the use of false or fraudulent director identities.

The director ID system, had it been in place, would have meant the key officers in Sterling were not in the ASIC database multiple times. This would have allowed a consolidated view of those officers. However, as discussed above, mere involvement in numerous companies that have been wound up is not an automatic bar of a person acting as an officer or director in the future. The director ID system, of itself, would not have prevented the key officers of Sterling from taking on those roles.

The implementation of a beneficial ownership register for companies is being actively considered by Government. Updates on implementation of the commitment relating to beneficial ownership transparency are set out at: https://ogpau.pmc.gov.au/national-action-plans/australias-first-open-government-national-action-plan-2016-18/12-beneficial. Any queries relating to the progress of the proposal should be directed to Treasury.

Unless significant changes were made to the licensing and registration regime for managed investment schemes, a register of beneficial ownership would not have had a significant impact in this matter.

An organisational chart for the Sterling Group was included at Appendix 1 to ASIC's original submission.