# Chapter 7

# Managed investment schemes and self-managed superannuation funds

7.1 The land banking schemes investigated in this inquiry featured both direct and indirect property investment—21st Century Group investors and some Market First investors invested through options agreements (indirect property investment), while some Market First investors invested through off-the-plan contracts of sale (direct property investment). Direct property investment is exempted from the Corporations Act but it is unclear whether options agreements in land banking, as an indirect property investment, could be regulated under the Corporations Act.

7.2 In this chapter, the committee looks at ASIC's current attempts to establish the status of options agreements in land banking schemes, as a form of indirect property investment, and whether they can be captured under the Corporations Act. The committee also examines the use of self-managed superannuation funds as a vehicle for property investment.

## Managed investment schemes

7.3 ASIC first became aware of potential problems with land banking schemes offering options to purchase in mid-2014. It commenced investigations into these schemes, which are (in part) aimed at determining whether the options agreements central to some land banking schemes fall under the Corporations Act. On 3 June 2015, the Senate Economics Legislation Committee questioned ASIC about complaints raised in media reports relating to land banking schemes. ASIC indicated that, while land banking schemes did not fit neatly into ASIC's jurisdiction, it was conducting active inquiries in relation to this issue.[1]

7.4 Two months later, on 7 August 2015, ASIC announced that it had initiated court proceedings in the Federal Court of Australia against companies associated with Mr McIntyre and the 21st Century Group. They related to their promotion and sale of interests to investors in five land banking schemes in Victoria and Queensland. As noted in chapter 2, the five projects are Botanica; Secret Valley Estate; Oak Valley Lakes Estate & Resort; Bendigo Vineyard Estate & Resort; and Melbourne Grove Estate.[2] ASIC's media release outlined the case:

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1 Mr Tim Mullaly, Senior Executive Leader-Financial Services, ASIC, *Proof Estimates Hansard*, 3 June 2015, pp. 21 and 22.

2 ASIC, 'ASIC acts against 21st Century Group and Jamie McIntyre land banking schemes', 15-214MR, 7 August 2015, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-214mr-asic-acts-against-21st-century-group-and-jamie-mcintyre-land-banking-schemes/ (accessed 4 January 2016).

> ASIC understands that there are over 100 investors in the schemes, which have been promoted to investors, including through seminars, by entities associated with Mr McIntyre's 21st Century Group. Companies associated with Mr McIntyre and the 21st Century Group are also the developers of the schemes (development companies).[3]

7.5 These proceedings are a litmus test for whether ASIC has the regulatory powers required to regulate certain land banking schemes and protect affected investors under the Corporations Act. ASIC argued that the land banking schemes in question fall within the Corporations Act as the investments are actually either:

- unregistered managed investment schemes; or
- a type of financial product (that is, options to purchase property).

7.6 If the Federal Court accepts ASIC's arguments about the legal nature of the land banking schemes, the 21st Century Group would be required to have Australian financial services (AFS) licences to market the schemes. Financial advisers who give advice on financial products must satisfy many obligations under the Corporations Act, including the Future of Financial Advice (FOFA) requirements in Part 7.7A of the Corporations Act, because they are providing a 'financial service'. The key elements of the FOFA reforms include:

- amendments to the conduct obligations for financial advisers, including an obligation to act in the client's best interests and to prioritise the client's interest when giving personal financial product advice (previously advisers were required to have a reasonable basis for advice);
- a prospective ban on conflicted remuneration, including commissions and volume-based payments;
- a requirement to send an annual fee disclosure statement to clients with ongoing fee arrangements;
- a requirement that advisers obtain their client's consent every two years to continue the ongoing fee arrangements (the 'opt-in' requirement); and
- enhanced licensing and banning powers for ASIC.[4]

7.7 In this case, ASIC would have the power to ensure that these investments fulfil the obligations on financial services providers in the Corporations Act, such as having dispute resolution systems in place and fulfilling disclosure requirements with investment documents. ASIC made the point that there are additional obligations that managed investment schemes are required to meet:

> If the land banking scheme is a managed investment scheme, there are strict legal requirements that must be met, including giving investors a product

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3 ASIC, 'ASIC acts against 21st Century Group and Jamie McIntyre land banking schemes', Media release 15-214MR, 7 August 2015.

4 ASIC, answer to question on notice, 30 November 2015, p. 10.

> disclosure statement (PDS). A PDS must include information about the scheme's key features, fees, commissions, benefits, risks and complaints handling procedure.[5]

7.8 Should the land banking schemes be recognised as a managed investment scheme, strict regulations would apply to the scheme. For example, the scheme could not operate without a responsibility entity (RE), which must be a public company that holds an Australian financial services licence (ASFL) authorising it to operate a managed investment scheme.[6] One of the duties of an RE is to hold scheme property on trust for scheme members.[7] In exercising its powers and carrying out its duties, the RE of a registered scheme must act honestly and exercise the degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's position. An RE must also, among other obligations, act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests.[8] An officer of the RE of a registered scheme is under similar statutory obligations.[9]

7.9 As the case has proceeded through the Federal Court, the 21st Century Group consented to ASIC's interlocutory application and Deloitte were appointed provisional liquidators of the development companies. Deloitte were scheduled to provide a report as to the affairs of the companies by 15 December 2015. On 3 December 2015, the Federal Court adjourned and re-listed the directions hearing for 5 February 2016.[10] On that day, the Federal Court re-listed the matter for a further hearing on 10 March 2016.[11]

7.10 Even if the Federal Court accepts ASIC's arguments, it does not follow that all land banking schemes, which have come to the attention of the committee (or any future schemes), would also be defined as financial products. Whether a scheme is captured by the Corporations Act will depend on the particular details of the scheme. As ASIC submitted:

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5 ASIC, answer to question on notice, 30 November 2015, p. 6.

6 *Corporations Act 2001*, s 601FA.

7 *Corporations Act 2001*, s 601FC(2).

8 *Corporations Act 2001*, s 601FC.

9 *Corporations Act 2001*, s 601FD.

10 ASIC, 'Jamie McIntyre and 21st Century land banking companies agree to the appointment of provisional liquidators and other interim orders', Media release 15-289MR (including updates), 7 October 2015.

11 ASIC, 'ASIC acts against 21st Century Group and Jamie McIntyre land banking schemes', 15-214MR, 7 August 2015, Editor's note 9, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-214mr-asic-acts-against-21st-century-group-and-jamie-mcintyre-land-banking-schemes/ (accessed 19 February 2016). The Federal Court also accepted an extension of the undertakings from Messrs Jamie and Dennis McIntyre that until 4pm on 10 March 2016, they would give notice to ASIC of any travel outside of Australia and deliver their passports to their solicitors.

> While ASIC does not regulate direct property investment, ASIC considers that land banking schemes, **depending on the particular scheme**, may be a managed investment scheme and/or a financial product and that the promoters of these schemes should therefore hold an Australian financial services licence and register these schemes with ASIC.[12]

7.11 There are likely to be additional opportunities to test the application of the Corporations Act to land banking schemes in the near future. ASIC told the committee that investigations are continuing into schemes promoted by Market First, in addition to the current proceedings against 21st Century Group and Mr McIntyre.[13]

7.12 Should the Federal Court not accept ASIC's arguments and decide as part of the final orders that the land banking schemes are not a financial product under the Corporations Act, the comprehensive licensing, conduct and disclosure regime covering financial services in chapter 7 of the Corporations Act will not apply to those schemes.

## Self-managed superannuation funds (SMSF)

7.13 ASIC informed the committee that approximately 60 per cent of investors who invested in land banking schemes did so through self-managed superannuation funds (SMSFs).[14] As many investors in land banking schemes used a SMSF, the committee is particularly interested in the regulatory regime for such funds.

7.14 While SMSFs are primarily regulated by the Australian Taxation Office, ASIC's role in relation to SMSFs is to regulate the 'gatekeepers' who provide advice on SMSFs including financial advisers, accountants, SMSF auditors and providers of products and services to SMSFs.[15] These services are regulated under the Corporations Act and the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

### *Investing through an SMSF*

7.15 In order to establish an SMSF, a trust must be created specifying the appointment of trustees, consideration of assets, identifiable beneficiaries and the intention to create a trust. Once an SMSF is established but before an SMSF can make an investment, the SMSF must have in place an investment strategy (the trust deed of a particular SMSF may dictate in which assets a fund can invest).[16] The investment strategy sets out the fund's investment objectives and specifies the type of investments

12 ASIC, answer to question on notice, 15 November 2015, pp. 2-3 (emphasis added).

13 Mr Tim Mullaly, Senior Executive Leader, ASIC, *Committee Hansard*, 30 September 2015, p. 64.

14 ASIC, answer to question on notice, 30 November 2015, p. 11.

15 ASIC, answer to question on notice, 30 November 2015, p. 8.

16 ASIC, answer to question on notice, 30 November 2015, pp. 9, 12.

the fund can make; the SMSF must make investments within the framework of the fund's investment strategy.[17]

7.16 Although there is no legislative requirement for a person to seek advice from a professional before deciding to establish an SMSF, ASIC noted that people will usually seek assistance at some point in the process:

> There is no requirement that a person seek advice before deciding to establish an SMSF. However, the engagement of professionals at some point is generally necessary in order to either establish the SMSF, seek advice on the type of investments to make or prepare annual financial statements. An SMSF auditor must be engaged to conduct an audit on the SMSF's financial statements and compliance with the superannuation laws each year.[18]

7.17 As a general rule, an SMSF may make any type of investment provided it is made on a commercial 'arm's length' basis and accords with the SMSF's investment strategy. While there are some restrictions in relation to lending money to relatives and borrowing to invest (with the exception of limited recourse borrowing arrangements), there are no restrictions on a person using their SMSF to invest in products or schemes promoted at investment seminars. Similarly, there are no regulatory legal impediments to stop a person investing in options in a land banking scheme through an SMSF.[19]

*Investing in property or options in land banking schemes and SMSFs*

7.18 Unlike advice on property investment, advice intended to influence a person to acquire, vary or dispose of a superannuation interest within the meaning of the SIS Act is financial product advice under the Corporations Act. Thus an adviser giving such advice must have an AFS licence.[20] For example, a spruiker who recommends to seminar attendees investing in property through establishing an SMSF may be providing financial product advice and should hold an AFS licence.

7.19 Through the work of a taskforce established in 2012, ASIC has been targeting property spruikers who break the law by providing unlicensed financial advice about SMSFs.[21] ASIC launched legal proceedings in November 2014 against Park Trent Properties Group Pty Ltd (Park Trent) that, by the time of the trial in June 2015, had

17 ASIC, answer to question on notice, 30 November 2015, p. 9.

18 ASIC, answer to question on notice, 30 November 2015, p. 9.

19 ASIC, answer to question on notice, 30 November 2015, p. 11.

20 Corporations Act, subsection 911A(1).

21 ASIC, 'Property spruiker found to have provided unlawful advice', Media release 15-300MR, 20 October 2015.

advised over 860 people to establish and switch funds into an SMSF to purchase investment property.[22]

7.20 In November 2014, when proceedings against Park Trent commenced in the Supreme Court of NSW, ASIC Commissioner Mr Greg Tanzer commented:

> Collectively, Australians hold over $1.85 trillion worth of assets in superannuation funds, with $557 billion held in SMSFs. It is important when making decisions regarding superannuation to consider obtaining appropriate advice from an authorised financial adviser.
>
> Dealing with an authorised adviser affords specific protections under the law, such as acting in the best interests of clients, a duty to avoid conflicts of interest and providing access to dispute resolution schemes.[23]

7.21 Park Trent had been promoting the use of SMSFs for property investment to attendees at seminars and to people who were visited on 'home visits' by Park Trent employees. Park Trent's business model was dependent on:

> …persuading relatively unsophisticated investors of the virtues of using their superannuation accounts to purchase investment properties and to establish SMSFs (at considerable expense) to enable the purchase to proceed.[24]

7.22 In an affidavit sworn during the hearing, one of Park Trent's employees stated that the Property Investment Analysis was developed by a company called Somersoft.[25] The program, which could be purchased by anyone for a fee, was designed to analyse the capital growth, cash flows and rates of return on investment properties, taking tax implications into account. Park Trent showed the Property Investment Analysis to clients who expressed interest in investing in a property through an SMSF, describing it as an aid 'to influence the individual in coming to a decision to adopt the strategy that's being put forward in the document'.[26]

7.23 The Supreme Court of NSW handed down final orders in ASIC's action against Park Trent on 27 November 2015.[27] The court found that Park Trent had

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22 ASIC, 'ASIC obtains final orders against Park Trent', Media release 15-358MR, 30 November 2015.

23 ASIC, 'ASIC seeks court order to stop property promoter from providing unlicensed financial product advice on SMSFs', Media release 14-299MR, 11 November 2014.

24 *Australian Securities and Investments Commission v Park Trent Properties Group Pty Ltd (No 3)* [2015] NSWSC 1527 at paragraph 499 (Sackville AJA).

25 *Australian Securities and Investments Commission v Park Trent Properties Group Pty Ltd (No 3)* [2015] NSWSC 1527 at paragraph 131 (Sackville AJA).

26 *Australian Securities and Investments Commission v Park Trent Properties Group Pty Ltd (No 3)* [2015] NSWSC 1527 at paragraph 137 (Sackville AJA).

27 *Australian Securities and Investments Commission v Park Trent Properties Group Pty Ltd (No 4)* [2015] NSWSC 1767.

unlawfully carried on an unlicensed financial services business for over five years by providing advice to clients to purchase investment properties through an SMSF. It made the following orders against Park Trent:

- a permanent injunction restraining Park Trent from providing unlicensed financial product advice to clients regarding SMSFs; and
- a requirement that Park Trent post a notice on its website outlining the orders made against it.[28]

7.24 There are similarities between the business models of Park Trent and the land banking schemes promoted by 21st Century Group and Market First. Many investors in land banking schemes invested through an SMSF.

7.25 There are two possible breaches which may have occurred in the case of land banking schemes: firstly, depending on the advice given at the investment seminars, the spruikers may have provided financial product advice in recommending that attendees invest through an SMSF and, as such, should have held an AFS licence. Given the spruikers did not hold an AFS licence on the assumption that they were only providing 'education', not financial advice, this would have been a breach of the Corporations Act. It is difficult for the committee, on the evidence received, to have a view on whether such a breach occurred.

7.26 The second possible breach would have occurred after attendees were referred to accountants and financial advisers in order to establish their SMSF and invest in the land banking scheme. Financial advisers providing advice on the establishment of, and the disbursement of funds from, an SMSF would definitely be providing financial product advice. Even before the FOFA reforms commenced, the Corporations Act required financial product advice to be appropriate and consider the client's best interests. It is highly unlikely that advice to establish an SMSF and invest almost all of a retail client's funds into one highly risky product, such as a land banking scheme, would meet the appropriateness requirements for financial product advice, particularly when the SMSF would have a low balance.

7.27 In this regard, the committee refers back to the evidence produced by some investors cited in Mr McIntyre's submission especially references to people investing 'the majority' or 'most' of their superannuation in land banking options.[29] The committee also notes that Ms Monka invested 90 per cent of her savings (around $60,000) through an SMSF in the Moira Park Green City development in 2011.[30] She did so after her own accountant advised that he was not in a position to advise her or establish an SMSF.[31]

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28 ASIC, 'ASIC obtains final orders against Park Trent', Media release 15-358MR, 30 November 2015.

29 See paragraph 6.27.

30 Ms Grazyna Monka, *Committee Hansard*, 30 September 2015, p. 9.

31 Ms Grazyna Monka, *Committee Hansard*, 30 September 2015, p. 8.

7.28 Although her SMSF now has very limited funds, Ms Monka is forced to pay sizeable fees annually to comply with the requirements under superannuation laws for financial statements.[32] As such, Ms Monka is paying a substantial portion of her remaining funds in fees every year.[33] Such a commitment to one asset class is contrary to sound financial advice, which advocates diversification as a means of reducing risk.

7.29 In July 2015, ASIC released guidance to advisers who provide personal advice to retail clients about SMSFs, which stated:

> In many cases, a recommendation for a retail client to set up an SMSF with a starting balance of $200,000 or below is unlikely to be in the client's best interests. The costs of establishing and operating an SMSF with a balance of $200,000 or below are unlikely to be competitive, compared to a fund regulated by the Australian Prudential Regulation Authority (APRA). Therefore, the client may not be in a better position when compared to using an APRA-regulated superannuation fund.
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> …
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> Where advice is provided to establish an SMSF with a low balance, we would expect the advice to clearly set out:
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> - the circumstances that influence the adviser to believe the client is likely to end up in a better position, despite the SMSF having a low starting balance
> - consideration of whether the SMSF's intended investment strategy is appropriate and viable
> - the reasons why setting up and operating an SMSF is in the best interests of the client.
>
> **Compliance tip:** We are likely to look more closely at advice to establish an SMSF, to consider whether the advice complies with the best interests duty and related obligations, if the starting balance of the SMSF is below $200,000.[34]

7.30 It should be noted that, based on her own experience, Ms Monka recommended that SMSFs should be banned for unsophisticated investors with less than $500,000 in funds and that establishing an SMSF should only take place after advice and sign-off from a licensed financial adviser.[35]

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32 Ms Grazyna Monka, *Committee Hansard*, 30 September 2015, p. 10.

33 ASIC, *Advice on self-managed superannuation funds: Disclosure of costs*, Information sheet 206, July 2015.

34 ASIC, *Advice on self-managed superannuation funds: Disclosure of costs*, Information sheet 206, July 2015.

35 Ms Grazyna Monka, *Committee Hansard*, 30 September 2015, p. 8.

### *Removal of the 'accountant's exemption'*

7.31 The regulatory regime for accountants providing advice on establishing an SMSF is currently more complicated than that for financial advisers. A person who carries on a business of providing financial product advice about an SMSF must hold an AFS licence and meet the obligations of providing financial product advice under the Corporations Act (described earlier). However, a number of licensing exemptions do apply, including for a 'recognised accountant' providing advice to establish or windup an SMSF.[36]

7.32 This exemption is colloquially known as the 'accountant's exemption', and allows accountants to establish an SMSF without satisfying the key elements of the FOFA reforms, such as the obligation to act in the client's best interests and the ban on conflicted remuneration. However, from 1 July 2016, accountants providing advice on SMSFs must be licensed under the Corporations Act. The removal of the accountant's exemption will have a positive effect on consumer protection in the SMSF sector, as ASIC emphasised:

> The effect of this change will mean that all advice to establish or windup an SMSF will fall within the AFS licensing framework and will also be subject to other obligations such as the best interest's duty and the requirement to provide a Statement of Advice.[37]

7.33 The rationale behind the accountant's exemption was that accountants, as an established profession, were required to meet high standards to obtain their qualifications and should not be required to meet the obligations financial advisers were required to satisfy under the Corporations Act. The involvement of accountants in the promotion of a number of schemes investigated by this committee, including in relation to land banking schemes and in the separate inquiry into forestry managed investment schemes, is evidence that accountants should be required to meet the same regulatory standards when providing financial product advice on SMSFs. As such, the committee considers that the removal of the accountant's exemption for SMSF advice is long overdue.

### *Committee view*

7.34 Armed with the evidence in this report, investors in land banking schemes may decide that it is prudent to seek advice from a licensed financial adviser (who is listed on ASIC's financial advisers register) as to whether their SMSF continues to be suitable for their circumstances.

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36 *Corporations Regulations 2001*, regulation 7.1.29A.

37 ASIC, answer to question on notice, 30 November 2015, p. 11.

## Conclusion

7.35 The courts are yet to decide whether some of the land banking schemes offering options are managed investment schemes or financial products. Should the courts find that they are, the investor protection regime, which has been significantly strengthened in recent years, will apply. If not the schemes remain outside this regime and investors will rely on the Australian consumer law and state and territory laws to safeguard their interests.

7.36 Investors who received advice to invest in land banking schemes through a self-managed superannuation fund have some protections under the Corporations Act. ASIC is aware of such activity and has taken action in the Trent Park case.

7.37 The committee is concerned about the use of SMSFs to invest in land banking schemes, especially where a substantial proportion of the funds are invested in such schemes. The committee contends that much greater publicity should be given to the injudicious use of self-managed superannuation funds and that all gate-keepers in the financial industry—financial planners, accountants, lawyers, media commentators and regulators—should make a concerted effort to educate investors on the pitfalls of doing so.