



**ASIC**  
Australian Securities &  
Investments Commission

# **Senate Inquiry into Sterling Income Trust**

## **Supplementary submission by the Australian Securities and Investments Commission**

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## A Overview

### Key points

Like most managed investment schemes, the Sterling Income Trust was set up as a trust and managed under a trust deed. The deed gave the trustee broad discretion about investment strategy and dealing with assets, and we understand that the funds invested in the Sterling Income Trust were generally used in a manner consistent with the trust deed.

The barriers to entry for a new managed investment scheme are modest and a very broad range of schemes are permitted, in keeping the policy underlying the financial services regime in Australia.

ASIC used its administrative stop order power in August 2017 as the most efficient and effective response at the time to prevent the Sterling Group signing up further clients at that time.

Following the issue of the administrative stop order, ASIC's investigation continued. ASIC used different tools at different points in the matter as appropriate based on the circumstances at the time. Court-based action was considered and used where appropriate.

- 1 The Australian Securities and Investments Commission (ASIC) thanks the Senate Standing Committees on Economics—Economics References Committee for the opportunity to provide this supplementary submission.
- 2 In this supplementary submission, ASIC sets out further context and detail on:
  - (a) the regulatory framework for managed investment schemes, including ASIC's regulation of responsible entities and Product Disclosure Statements (PDSs);
  - (b) the regulatory 'toolkit' available to ASIC in relation to managed investment schemes, and Sterling Income Trust's use of the phrase 'trust' and 'trust account'; and
  - (c) ASIC's actions in relation to the Sterling Group between the issue of an interim stop order and issue of a statement of concerns in August 2017 and the beginning of Theta Asset Management Ltd (Theta) winding up the Sterling Income Trust in August 2018.

## The regulatory framework for managed investment schemes

- 3 In Section B of this submission, we discuss, as has been emphasised throughout this Inquiry, how ASIC’s ability to exercise discretion in relation to the setting up of a managed investment scheme is limited.
- 4 If the statutory requirements are satisfied, ASIC must issue an Australian financial services (AFS) licence to any applicant who applies. If the statutory requirements are satisfied, ASIC must register a scheme.
- 5 ASIC cannot refuse an application for an AFS licence for reasons beyond the relevant criteria (e.g. we cannot refuse to grant a licence on the basis of the licensee’s proposed business model). This reflects the policy approach underlying the current Australian financial services regulatory regime which is designed to let entities enter the market as outlined in the final report of the 1996 Financial System Inquiry (Wallis Inquiry).
- 6 This regime is based on competitive neutrality and minimal regulatory burdens:
- Competitive neutrality requires that the regulatory burden applying to a particular financial commitment or promise apply equally to all who make such commitments. It requires further that there be:
- minimal barriers to entry and exit from markets and products;
  - no undue restrictions on institutions or the products they offer; and
  - markets open to the widest possible range of participants.<sup>1</sup>
- 7 At most, the licensing process seeks to ensure that an entity is confined to providing financial services that it has adequate resources and is competent to provide at the time of application. It does not involve an endorsement of the business models adopted by the applicant.
- 8 The fact that a financial product provider is ‘licensed’ or a managed investment scheme is ‘registered’ does not necessarily mean that ASIC has closely considered the desirability, robustness, or risk profile of their products. Licensing and registration should be understood as imposing legal obligations on the AFS licensee and the responsible entity, with ASIC undertaking risk-based surveillance to enforce compliance with those obligations.

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<sup>1</sup> See Wallis Inquiry, [final report](#), 1 March 1997, Part 5: Philosophy of Financial Regulation, p. 197.

## ASIC's powers and regulatory toolkit

- 9 In Section C of this submission, we discuss the regulatory toolkit available to ASIC in relation to managed investment schemes such as the Sterling Income Trust. In particular, court-based actions including injunctions and the winding-up of managed investment schemes require a high degree of admissible evidence and certainty before ASIC can bring a proceeding.
- 10 We also discuss the use of the words 'trust' and 'trust account' by the Sterling Group: the Sterling Income Trust was a legal trust, but did not operate a 'trust account' in the same sense as a solicitor's or real estate agent's trust account.

## ASIC's oversight of the Sterling Group

- 11 In Section D of this submission, we set out ASIC's investigatory and enforcement actions in relation to the Sterling Group between August 2017 and June 2019 to supplement the information provided in ASIC's initial submission to this Inquiry.
- 12 During this period, ASIC worked continuously to deal with the issues arising from the Sterling Income Trust, despite what has been described as a 'whack a mole' situation in which the Sterling Group continued to persist in fundraising as each previous avenue of fundraising was closed.
- 13 ASIC considered appropriate interventions, and protection of the vulnerable and elderly tenants. We dealt with the Sterling Group's attempts to continue fundraising after we had issued stop orders.
- 14 As circumstances changed, ASIC's compliance and enforcement approach also changed. One result of those actions is the brief currently with the Commonwealth Director of Public Prosecutions (CDPP) to consider criminal prosecution in relation to a range of potential offences involving the Sterling Group.

## B The regulatory framework for managed investment schemes

### Key points

Under the Corporations Act, ASIC must register a managed investment scheme within 14 days of lodgement of an application, unless it appears to us that certain matters have not been satisfied.

In ASIC's experience, some investors assume that a managed investment scheme has been reviewed or approved by ASIC simply because it has been registered.

ASIC does not review the viability of the underlying business model before a scheme is launched. ASIC also does not review or receive a copy of the PDS before a new retail product is launched (unless it is to be listed).

### Licensing the responsible entity

- 15 Currently, s913B of the *Corporations Act 2001* (Cth) (Corporations Act) states that 'ASIC *must* grant an applicant an Australian financial services licence' if particular requirements are satisfied. ASIC is required to grant a licence when the applicant satisfies the relevant criteria, and there is no residual or 'catch-all' discretion for ASIC.
- 16 While some of the factors may suggest a degree of discretion, court decisions have held that the 'no reason to believe' test requires actual evidence that the applicant has been involved in illegal activity, not just mere suspicion. This is a high bar to clear.
- 17 The 2017 Treasury's 'ASIC Enforcement Review Taskforce' recommended and the Government adopted a number of changes to the licensing provisions administered by ASIC. However, some additional issues were not addressed at that time as described below.
- 18 If it were considered desirable to give ASIC a greater discretion in the licensing process, the primary licensing provision in s913B could be amended to 'ASIC *may* grant a licence' (rather than 'ASIC *must*') if certain criteria are met. This would mean that, for the applicant, the award of a licence is more akin to a *privilege* rather than a right.
- 19 Alternatively, the law could provide a residual 'catch-all' discretion to broaden the circumstances in which ASIC may refuse a licence (i.e. 'ASIC *must* grant a licence if the following conditions are met ... unless there is any other reason which in ASIC's reasonable opinion justifies the refusal of the application').

- 20 Similar amendments could be made to the provisions in the Corporations Act dealing with when ASIC can suspend or remove a licence. Nevertheless, under administrative law principles, any refusal to grant a licence by ASIC would be subject to administrative review, and ASIC would have to have good grounds for such a refusal.<sup>2</sup>
- 21 Theta was the responsible entity for multiple funds across multiple unrelated investment managers (sometimes known as a ‘an RE for hire’). Such responsible entities can be higher risk because they manage multiple schemes for multiple unrelated investment managers and promoters. Where problems arise in one of the schemes they manage, this can put the responsible entity under significant regulatory and financial strain, which can imperil all of the other schemes they manage.
- 22 To the extent that they are higher risk, it may be appropriate for different requirements to apply to ‘REs for hire’. For example, it may be that higher financial requirements (net tangible assets) or professional indemnity insurance requirements (or both) should apply to such business models.

## Registering a managed investment scheme

- 23 Under the Corporations Act, ASIC *must* register a managed investment scheme within 14 days of lodgement of an application, unless it appears to us that certain matters have not been satisfied. Those matters are set out at paragraph 130 of ASIC’s initial submission.
- 24 Again, ASIC does not have a residual discretion to refuse to register a managed investment scheme where the above statutory requirements are satisfied. For example, the mere fact that the directors of the Sterling Group had been directors of a large number of previous corporations did not and would not allow ASIC to refuse to register a managed investment scheme in which they were involved.
- 25 In listening to the evidence of Sterling tenant-investors, ASIC has noted a community perception that in ‘registering’ a managed investment scheme, ASIC vets or otherwise conducts due diligence on that scheme. This does not occur. However, this (mis)perception by Sterling tenant-investors is consistent with ASIC’s experience more broadly.

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<sup>2</sup> See also [ASIC Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the collapse of Trio Capital Limited](#) (PDF, 766 KB), September 2011, paragraphs 83–87.

- 26 The use of the phrase ‘registered managed investment scheme’ is sometimes interpreted to involve a greater degree of merit regulation than is actually the case. Schemes that are novel, risky, illiquid, leveraged or speculative can be registered and sold in Australia. Licensing does not equate to an approval by ASIC or indicate some level of the quality of financial services provided by the licensee.
- 27 ASIC is considering what actions may be taken to address the perception that ASIC ‘vets’ managed investment schemes, both in terms of communication and outreach to the community but also for law reform relating to ASIC’s regulation of these schemes. There is a gap between investor expectations and the requirements of the regime for registering schemes which should be addressed.
- 28 In ASIC’s experience, some investors assume that a managed investment scheme has been reviewed or approved by ASIC simply because it has been registered. The current registration process may contribute to this because it requires ASIC to check certain matters before registering a scheme.
- 29 ASIC suggests that consideration could be given to streamlining this process so that ASIC may register a scheme provided that:
- (a) the operator holds the relevant AFS licence; and
  - (b) the registration forms have been completed (with attachments) and signed by on behalf of the licensee.
- 30 That is, the legislation could make it clear that registration is a mere administrative process and does not involve merit review of the proposed scheme by ASIC.

## Scheme formation and constitution

- 31 The constitution of a registered scheme must be a legally enforceable document between the responsible entity and members that sets out some or all of the rights, duties and liabilities of the responsible entity in its operation of the scheme.
- 32 Specifically:
- (a) the constitution of a registered scheme must make adequate provision for, or specify, certain prescribed matters (see s601GA); and
  - (b) the constitution of a registered scheme must be contained in a document that is legally enforceable between the members and the responsible entity of the scheme (see s601GB).

Note: For more information, see ASIC’s [Regulatory Guide 134 Funds management: Constitutions](#) (RG 134) at RG 134.3–RG 134.5.



- 33 Many managed investment schemes are set up as trusts. The Sterling Income Trust was a trust, specifically a unit trust. Its trustee was Theta, which was also the responsible entity of Sterling Income Trust (once it was registered as a managed investment scheme). This is a common structure for managed investment schemes.
- 34 It is apparent from the submissions and evidence to the hearing that some of the marketing for the Sterling New Life Lease (SNLL) product (and potentially SNLL representatives) used the phrase ‘trust account’ or ‘trust fund’ to suggest that funds invested in the Sterling Income Trust would be held in a protected account which could not be used for the operating expenses of the trust, like a law firm or real estate agent’s trust account. Many investor-tenants thought that their money would be ‘safe’ and protected, and not used by the scheme operator, by being placed in a ‘trust’.
- 35 The manner in which funds are held on trust is primarily governed by the trust deed. A law firm trust account and a real estate agent trust account are subject to further additional obligations arising from specific laws governing lawyers and real estate agents, and can only be placed in very safe assets such as an account with an Australian deposit taking institution (ADI). Funds held in a ‘general’ trust are not necessarily subject to the same obligations.
- 36 In the Sterling matter, the funds placed in the Sterling Income Trust were used to purchase units in the trust. The value of those units were necessarily tied to the value of the Sterling Income Trust assets, and those funds were then used for the Sterling Group’s operational costs (including paying out SNLL rent). The Sterling Income Trust ‘trust deed’ gave Theta, as the trustee, very broad powers and authority to buy and sell, trade and otherwise deal with the trust assets with ‘absolute and uncontrolled discretion’.
- 37 As set out in paragraphs 93–94 of ASIC’s initial submission, we understand that the funds invested in the Sterling Income Trust were:
- (a) generally used in the manner set out in the relevant disclosure documents; and
  - (b) used to meet redemption requests of unit holders (as also set out in the relevant disclosure documents).
- 38 The word ‘trust’ is not protected in the law. It was not misleading, of itself, to refer to the Sterling Income Trust as a ‘trust’. While the use of ‘trust account’ appears to have contributed to Sterling investor-tenants being misinformed, ASIC does not think it is appropriate to regulate the use of the word ‘trust’ or ‘trust account’, which has broad and flexible meanings in trade and commerce. ASIC will continue to provide and improve financial literacy resources and outreach.

## Product Disclosure Statements

- 39        ASIC does not review the viability of the underlying business model before a scheme is launched. Nor does ASIC review or receive a copy of the PDS before a new retail product is launched (unless the product is to be listed). ASIC is merely ‘notified’ that a new PDS has been issued on the market.
- 40        The law makes product issuers responsible for ensuring that a PDS meets the requirements of the relevant provisions of the Corporations Act and its related regulations. ASIC issues regulatory guidance to assist in this regard. ASIC’s powers of investigation and enforcement in relation to managed investment schemes is discussed further in the next section.
- 41        Around 2,900 managed investment scheme PDSs are issued each year, which is a subset of the total 4,000–6,000 total PDSs each year. ASIC reviews around 90 managed investment scheme PDSs per year. Of these, around six stop orders on managed investment scheme PDSs are issued each year (being a mixture of interim and final stop orders).

## C ASIC's powers and regulatory toolkit

### Key points

ASIC cannot take a 'blanket' or all-inclusive approach to supervising managed investment schemes.

The volume of managed investment schemes in operation in Australia—currently around 3,600—means that such an approach is not feasible.

ASIC has a range of administrative, licensing, injunctive and winding up powers available in relation to managed investment schemes.

A range of procedural and practical issues apply to each of them and these influence ASIC's decision which tools to use in the circumstances of each case.

### Risk-based approach to investigation

- 42 A 'blanket' or all-inclusive approach to supervising managed investment schemes would be inconsistent with the broader regulatory framework for managed investment schemes in Australia, which provides for a non-prescriptive and disclosure-based approach to these schemes.
- 43 ASIC takes a risk-based approach to investigating managed investment schemes and associated issues. This is often triggered by a breach notification from the responsible entity, a report from a compliance plan auditor or compliance committee, a person reporting misconduct, or our targeted surveillance of entities or sectors identified as problematic.
- 44 Where an entity is targeted for surveillance, the approach towards that entity varies with the circumstances. We may initiate an active dialogue with the entity's senior executives and conduct meetings to ascertain information. We may also request and examine documents, including disclosure documents, and write to the responsible entity requiring it to respond to the issues we have raised.
- 45 Where a responsible entity does not voluntarily produce documents or engage with us, we may exercise our compulsory powers under s33 of the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) and s912C of the Corporations Act. In relation to the Sterling Group, ASIC used all three approaches, along with others.
- 46 If evidence of misconduct has been obtained there are a number of regulatory and coercive powers ASIC may use to protect consumers, depending on the nature of the misconduct and other circumstances. Exercising any of these powers requires significant preparation in framing and articulating the issues, gathering and preparing evidence, and often obtaining court orders as outlined in this section.

## Public warnings and stop orders

- 47 ASIC has the power to issue a public warning where we have reasonable grounds to suspect conduct that contravenes certain parts of the ASIC Act (e.g. the prohibition on misleading or deceptive conduct).
- 48 Because this is a regulatory action, procedural fairness principles apply and ASIC is generally required to inform an entity that it is considering issuing a public warning and giving them an opportunity to make submissions before a final decision is made on the public warning.
- 49 ASIC may issue stop orders which forbid a company from issuing financial products under the relevant disclosure document where the document is misleading or deceptive, omits required information, or is out-of-date. We may issue interim stop orders, through a delegate independent of the operational team investigating the document, for a maximum of 21 days.<sup>3</sup>
- 50 Before making a final stop order, ASIC must hold a hearing before such a delegate and give a reasonable opportunity to any interested person to make oral or written submissions to ASIC on whether an order should be made.

## Licensing and banning action

- 51 ASIC can vary, suspend or cancel a responsible entity's AFS licence, or ban a person from providing financial services, where among other things:
- (a) the responsible entity's officers are not, or are no longer, fit and proper persons given the considerations in s913BB of the Corporations Act;
  - (b) a banning or disqualification order is made against a responsible entity or a representative of the responsible entity; or
  - (c) ASIC has reason to believe that the responsible entity is likely to contravene its obligations under s912A of the Corporations Act.
- 52 Section 912A requires a licensee to, among other things, do all things necessary to ensure that the financial services covered by the licensee are provided efficiently, honestly and fairly. For ASIC to have 'reason to believe', the material relied on 'must be convincing'. Belief must be determined on an objective basis.<sup>4</sup>
- 53 Key factors include, among other things, the nature and seriousness of the suspected misconduct, including whether the conduct shows deliberation or planning in wilfully disregarding the law, whether there is evidence to show

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<sup>3</sup> Corporations Act, s1020E; see also information on [stop orders](#) on ASIC's website.

<sup>4</sup> *Power v Hamond* [2006] VSCA 25, [105]–[106]; *Poidevin v Australian Securities and Investments Commission* [2019] AATA 6806, [674].

the contravention involved dishonesty or was intentional, reckless or negligent and whether the conduct is continuing or appears likely to recur; whether the licensee has effective internal controls; the licensee's conduct after the alleged contravention occurred; the expected public benefit; and any mitigating factors.<sup>5</sup>

- 54 Again, the licensee (in this case, the responsible entity) is entitled to a hearing and to make submissions to ASIC about the matter. ASIC may cancel the AFS licence or make a banning order immediately where, among other things, the responsible entity is convicted of a fraud offence or is insolvent under administration under administration or members have suffered, or are likely to suffer, loss or damage because the responsible entity has breached the Corporations Act.
- 55 Regardless of whether the responsible entity is entitled to a hearing or not, ASIC's decision is subject to merits review by the Administrative Appeals Tribunal, and possibly judicial review. As a decision maker, ASIC is therefore required to afford the responsible entity the benefits of natural justice, to act fairly and with detachment, to set out findings on material questions of fact, to refer to evidence and materials on which the decision is based and to set out reasons for the decision.<sup>6</sup>

## Court-related actions

### Court-ordered injunctions

- 56 ASIC can apply to a court for an injunction under s1324 of the Corporations Act, in circumstances where a person has, is or is proposing to engage in conduct that would constitute a contravention of the Act. While s1324 is broad in its terms, the courts have held that 'an injunction should not be granted unless the order is directed to and appropriate to achieve an end such as enforcing and giving effect to the statute'.<sup>7</sup>
- 57 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 s1324(4) (as for traditional injunctions), 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.<sup>8</sup>

<sup>5</sup> See ASIC's [Regulatory Guide 98](#) *ASIC's powers to suspend, cancel and vary AFS licences and make banning orders* (RG 98) at RG 98.13 and RG 98.19.

<sup>6</sup> *Minister for Immigration & Ethnic Affairs v Pochi* (1980) 31 ALR 666, at 140.

<sup>7</sup> *Australian Securities and Investments Commission v Pegasus Leveraged Options Group Pty Ltd* (2002) 41 ACSR 561, 583.

<sup>8</sup> *Corporate Affairs Commission (NSW) v Lombard Nash International Pty Ltd* (1986) 11 ACLR 566 (Young J).

### **Court-appointed receivers and asset preservation orders**

- 58 ASIC can seek to have a receiver appointed under s1323 of the Corporations Act, by court order, where an investigation is being carried out, a prosecution or civil proceeding has begun, and where ASIC can persuade the court that it is necessary to appoint a receiver to protect aggrieved persons to whom the entity may become liable; or where it appears that a financial services licensee has contravened certain provisions of the Act.
- 59 Courts have stated that the power to appoint a receiver is an ‘extraordinary step’ which is ‘drastic, harsh and dangerous’ and a ‘extraordinary and drastic remedy, to be exercised with utmost care and caution’.<sup>9</sup>
- 60 ASIC can seek asset preservation orders under s1323, but this is only available where the court is satisfied that the grounds for appointing a receiver under s1323 have been made out,<sup>10</sup> and are sometimes used as an alternative to the appointment of a receiver.
- 61 ASIC considered asset preservation orders as part of its investigation, but considered there were not sufficient remaining assets which warranted action at the time.
- 62 Courts have emphasised that as asset preservation orders inevitably intrude upon private rights, ASIC in particular must ‘not abdicate from its responsibility to make sure that the orders that it makes operate in a manner that is proportionate and not more intrusive than is necessary’.<sup>11</sup>

### **Court-ordered winding up of the company or scheme**

- 63 ASIC can seek to wind up the company on just and equitable grounds by order of a court, where ASIC can persuade a court that the company has engaged in conduct which is contrary to the interests of the members as a whole or oppressive to, or unfairly prejudicial to, or unfairly discriminatory against members.
- 64 Appointing a liquidator is equally as (if not more) harsh as appointing a receiver because it results in the corporate death of the entity. Given the potential for the ultimate termination of an (often solvent) company, this long and usually contested process requires preparation of evidence and often a full trial before a court.

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<sup>9</sup> *ASIC v Burke* [2000] NSWSC 694 at [8], *Australian Securities and Investments Commission v Adler* (2001) 38 ACSR 26 at 268–9, *ASIC v Carey* (No 3) (2006) 232 ALR 577 French J at [29], *Bond Brewing Holdings Ltd v National Australia Bank Ltd* (1990) 1 ACSR 445, 458.

<sup>10</sup> *Australian Securities and Investments Commission v Ostrava Equities Pty Ltd* (2015) 106 ACSR 332 at [11]

<sup>11</sup> *Re HIH Insurance Ltd (in prov liq)*; *Australian Securities and Investments Commission v Adler* (2001) 38 ACSR 266 at [7].

- 65 Courts have said that winding-up:  
is to be regarded as a remedy of last resort and one which ought not to be granted if some other less drastic form of relief is available and appropriate ... if some other less drastic form of relief is available and appropriate, it can then be seen that the applicant for winding-up is acting unreasonably in seeking such an order, even if such an applicant has cogent reasons to advance in support of the application.<sup>12</sup>
- 66 ASIC can seek to wind up the company on the grounds of insolvency by order of the court. Again, this is a drastic step that results in the termination of a company and is often contested. The same high hurdles and principles apply to winding up as for appointing receivers. The question of insolvency is also often a complex one, particularly in the case of the Sterling Group, with its complex financial products and many inter-related corporate entities.
- 67 Proving insolvency to the satisfaction of a court will be more difficult where (as is often the case) the company does not cooperate with ASIC and ASIC must use coercive powers to obtain the company's books and records (including financial records). Expert evidence may be required, as insolvency is often an issue of opinion;
- 68 Pending the hearing of a winding up application, ASIC can seek to appoint a provisional liquidator to the company by court order, to preserve the status quo pending the hearing. Because appointing a provisional liquidator takes control of the company outside the directors' hands and often significantly reduces the value of the company in any potential sale, such an appointment is usually granted with reluctance by the court. As an indication, courts have described it as a 'drastic intrusion into the affairs of the company and will not be done if other measures would be adequate to preserve the status quo'.<sup>13</sup>
- 69 ASIC can also seek to wind up a managed investment scheme by obtaining a court order on the just and equitable ground (as discussed above). Where a responsible entity is being wound up, whether or not a scheme managed by the responsible entity is wound up will depend on whether the responsible entity can be replaced; the availability of a suitable operational manager to manage the scheme's projects; and the viability of the scheme, including the willingness and ability of existing scheme members to pay for any shortfall in operating expenses and the long-term profitability outlook for the scheme.
- 70 ASIC can seek to appoint a temporary responsible entity to the scheme. Members can choose a new responsible entity for their scheme, and in limited circumstances ASIC or members can apply to the court to appoint a temporary responsible entity. It can be difficult to find another responsible entity willing to become the temporary or replacement responsible entity for a scheme in financial distress.

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<sup>12</sup> *ABN 90 103 392 182* [2019] QSC 194 at [49].

<sup>13</sup> See, for example, *Australian Securities and Investments Commission (ASIC) v ActiveSuper Pty Ltd (No 2)* (2013) 93 ACSR 189 at [13] (Gordon J).



## **Declarations of contraventions, penalty orders and/or compensation orders**

- 71 ASIC can seek court orders for declarations of contraventions, pecuniary penalty orders or compensation orders for certain contraventions of the Corporations Act. In 2020, ASIC obtained declarations under s1317E that (among other things) Theta had contravened s601FC and 601FD of the Corporations Act by not exercising the degree of care and diligence required, in issuing PDSs for Sterling Income Trust which contained misleading or deceptive statements.
- 72 The court consequently made disqualification orders under s206C of the Corporations Act and pecuniary penalty orders under s1317G of the Act. In this matter, ASIC has chosen not to enforce the pecuniary penalties so as not to deplete any funds that may be available to creditors including Sterling victims.

## **Practicalities of taking action**

- 73 Each of the powers available to ASIC as described involves a substantial interference in the ability of a private business to operate. Such action is usually detrimental and often fatal to the overall viability of the scheme. ASIC action in this context often causes or crystallises losses to existing investors.
- 74 While the Sterling Income Trust caused devastating losses for consumers, many of the businesses which ASIC receives reports of misconduct on, and many of the businesses which ASIC investigates, are legitimate businesses which have not engaged in any wrongdoing. Where they have engaged in wrongdoing, the nature of the wrongdoing may mean that the appropriate outcome is not any of the more drastic steps outlined above. If enforcement steps are taken without good grounds or on the basis of inadequate evidence, the harm suffered by a business and its investors can be enormous.
- 75 As a result, ASIC is required to have well-established bases for taking enforcement action and must obtain detailed, persuasive and admissible evidence prior to taking the above enforcement steps.
- 76 Many of the above enforcement actions require court orders. If ASIC does not present an overwhelming case (and sometimes even if ASIC does present an overwhelming case), the proceedings will often be vigorously contested—if ASIC is successful, this often spells the end of a business.



- 77 In addition to disputing allegations of misconduct, corporations will often argue that a forced winding-up of a company will destroy more value than an ‘orderly’ voluntary winding-up, and this lost value would result in lower returns to creditors and investors—often, the victims of the wrongdoing.
- 78 Even when matters are not contested, ASIC must satisfy the court that the orders sought are actually required and satisfy the relevant legal tests. For this reason and others, courts are correctly reluctant to take the steps outlined above, as shown by the quotes set out above.
- 79 The importance of obtaining admissible evidence and grounds prior to taking court action has another dimension for ASIC as regulator. As Justice McKerracher noted at the conclusion of his 110-page judgement imposing a civil penalty against Theta:<sup>14</sup>
- ...regulatory proceedings by their nature typically incur greater upfront cost in the preparation of the claim because the regulator must ensure that it knows the scope of the documents relevant to particular issues and that the cooperation of any third parties, as well as officers and employees will be forthcoming. ASIC understandably requires a reasonable degree of confidence in such matters before it can commence proceedings to support and make out any allegations of contraventions.

## Public warnings

- 80 Submissions have suggested that ASIC should make greater use of public warnings in relation to risky or ‘dangerous’ products. However, the public warning power only applies to conduct that *breaches* the ASIC Act, not to inherently risky products or services as such.
- 81 It is important to note that a public warning from ASIC about a business can have a devastating impact on a business. It would not be appropriate or indeed possible for ASIC to use its public warning powers based on mere complaints, allegations or suspicions alone. ASIC first needs to conduct inquiries and collect evidence before it can reasonably issue a public warning.
- 82 ASIC exercises its public warning powers in the following circumstances:
- (a) ASIC may issue a notice warning the public about the conduct of a *person* in relation to financial services (see s12GLC of the ASIC Act); and
  - (b) ASIC has the power to issue a public warning where we have reasonable grounds to suspect a contravention of the relevant parts of the ASIC Act (e.g. misleading and deceptive conduct).

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<sup>14</sup> *Australian Securities and Investments Commission v Theta Asset Management Limited* [2020] FCA 1894 at [365].

- 83 Each is a regulatory decision and requires ASIC to follow procedural fairness steps. This generally involves informing the affected entity of our intention to issue a public warning and giving them an opportunity to be heard (e.g. make a submission).
- 84 The public warning power is useful in cases where the relevant party is unlicensed and does not have any regulated disclosure documents in the market (i.e. PDSs). Where they do have a licence and a regulated disclosure document, it may be quicker for us to take direct action (e.g. a stop order). This is what we did in the Sterling matter.
- 85 The CHOICE submission says that ‘ASIC should use its new product intervention powers to address emerging managed investment scheme risks’. The public warning power only relates to situations where we have reasonable suspicion of relevant contraventions of the ASIC Act. It is not a general power to warn investors about ‘dangerous’ or ‘risky’ products.
- 86 If it were considered desirable to give ASIC a broader public warning power, the power could 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’. This would bring into the scope of the public warning power the types of situations potentially amenable to a product intervention order.

## D ASIC's oversight of the Sterling Group

### Key points

ASIC undertook a series of actions in relation to the Sterling Group between August 2017 (when the interim stop order was issued and Statement of Concerns was provided) and June 2019 (when the Sterling Group entered into liquidation).

ASIC worked continuously in relation to the Sterling Income Group during that period, which was a particular focus in the hearings for the Inquiry.

ASIC considered appropriate interventions, and protection of the vulnerable and elderly tenants. We dealt with the Sterling Group's attempts to continue fundraising after we had issued stop orders.

As circumstances changed, ASIC's compliance and enforcement approach also changed. One result of those actions is the brief currently with the Commonwealth Director of Public Prosecutions (CDPP) to consider criminal prosecution in relation to a range of potential offences involving the Sterling Group.

### Stop orders (August 2017)

- 87 As described in ASIC's initial submission, on 9 August 2017, ASIC issued an interim stop order on the (then) three current PDSs for the Sterling Income Trust.
- 88 Under the law, ASIC cannot issue a final stop order without first providing an administrative hearing and providing a reasonably opportunity for any interested persons to make verbal or written submissions to ASIC on whether the final stop order should be made. The statement of concerns provided to Theta alongside the interim stop order on 9 August 2017 was provided as part of this process, in line with ASIC's usual practice and in accordance with ASIC's legal obligation to provide procedural fairness.
- 89 The statement of concerns was detailed to support the procedural fairness and hearing process. Giving strong, clear and detailed reasons for the proposed final stop order ensures the parties are fully prepared for the hearing. It also shows the parties that ASIC is well prepared, and ready and willing to pursue the final stop order unless the entity has a strong counter-argument. In this case, in the light of the detailed statement of concerns, Theta decided not to contest the proposed final stop order.
- 90 An interim stop order makes it illegal to issue any further financial products under a PDS while the interim stop order is in force. On 29 August 2017, a final stop order was issued for the current PDSs. ASIC considered that the stop order was appropriate because it would have an immediate effect of

stopping the use of the PDSs. This was the immediate issue at the time and was clearly within ASIC's jurisdiction (court orders were not required). ASIC publicised the stop order by national media release, and a copy was posted to our website.

- 91 ASIC will publish a media release to publicise a stop order where it thinks it is important to bring the stop order to the attention of existing investors and to ensure that the stop order is on the public record and searchable by future investors (if another PDS is issued for the product in the future).

Note: We are aware from submissions and evidence to the Inquiry that some tenant-investors did find the media release and stop order while doing research about the Sterling Group. Some did still decide to proceed with the SNLL and Sterling Income Trust, even after finding out about the stop order.

- 92 In hindsight, ASIC acknowledges that there may have been more we could have done to bring the stop order to the attention of existing investors, so they could consider whether or not they wanted to make a complaint about the defective PDSs, and potentially seek a refund of their investment. We are considering how we might better publicise stop orders in the future.

- 93 A small number of Sterling investors took complaints to the Australian Financial Complaints Authority (AFCA) seeking a refund on the basis that they had invested in reliance on the defective PDS. As discussed in the hearing, ASIC did not at the relevant time, and does not now, have the power to direct responsible entities to contact investors and make them aware of the issues leading to the stop order, and their right to complain, following a defective PDS.

- 94 Theta subsequently developed and issued a revised PDS, as Theta was entitled to do under the law. As described previously in ASIC's response to Questions on Notice 1(b), ASIC did not endorse or otherwise approve the PDS issued by Theta on 27 October 2017.<sup>15</sup> ASIC was only notified that the second PDS had been issued on 9 November 2017.

- 95 The stop order did not end or even suspend ASIC's investigation of the Sterling Income Trust:

- (a) In September 2017, ASIC prevented seminars for Sterling Income Trust and Sterling New Life products from being held, relying on the stop order, and liaised with the Western Australia Department of Mines Industry Regulation and Safety (Consumer Protection Division) (WA DMIRS).
- (b) On 11 September 2017, ASIC issued a s912C notice on Libertas Financial Planning, seeking information on, among other things, its oversight of the SNLLs. The response was received on 13 September 2017 and carefully reviewed.

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<sup>15</sup> Response to Senator Scarr QON submitted 17 November 2021

- (c) On 15 September 2017, ASIC requested Sterling First provide ASIC with materials relating specifically to the SNLL product. Sterling First provided a response, along with SNLL materials, on 18 September 2018.

96 ASIC has considered whether it could and should have done more in relation to the marketing and advertising of the combination of the SNLL and Sterling Income Trust. At the time, we considered that our jurisdiction was limited to the financial product, being the Sterling Income Trust. In hindsight, we may have taken action, jointly with the WA DMIRS, in relation to the marketing of the overall SNLL arrangement.

## Lodgement of 2017 financial statements (September 2017)

97 On 29 September 2017, ASIC received Theta's lodgement of audited financial statements and reports for the Sterling Income Trust for the 2016–17 financial year, which noted a material uncertainty as to the Sterling Income Trust's ability to continue as a going concern. This issue was not raised in the reports for 2012–13 through to 2015–16.

98 While the statement of material uncertainty was of great interest to ASIC, it was not of itself sufficient for ASIC to obtain winding-up orders against Sterling Income Trust or Theta. For one thing, the auditor's comment stated only that 'a material *uncertainty* exists that *may* cast significant doubt on the [Sterling Income Trust's] ability to continue as a going concern'.

99 The director of Theta, Robert Marie, signed off on the material uncertainty issue, stating that as director of Theta, he believed that Sterling Income Trust and its controlled entities 'will continue as a going concern as they regularly monitor the operations of the sub-trusts and that financial support is provided by Sterling First (Aust) Ltd and its controlled entities'.

100 At this point, ASIC needed to obtain further evidence and conduct further analysis as to the Sterling Income Trust's financial position. On 2 November 2017, ASIC issued a notice under s912C of the Corporations Act to Theta, requesting information in relation to the auditor's statement. Theta, in its reply on 16 November 2017, disputed whether that material uncertainty as to solvency existed.

101 ASIC then conducted a close financial analysis of the financial accounts and financial information of the Sterling Income Trust. As outlined in Section C, there is a very high bar to convince a court that a company should be put into provisional liquidation or another form of insolvency administration, because doing so can have extremely detrimental outcomes for the company, its employees and its creditors. It is an extraordinary step for a court to order that a company to be shut down.

- 102 Throughout the period from November 2017 to March 2018, ASIC gathered evidence and analysed Sterling Income Trust’s complex business model and the flow of funds within the company, to determine whether ASIC could prove in court that the Trust was insolvent and should be wound up.
- 103 Between March 2018 and April 2018, ASIC intensified its efforts to ensure that the Sterling Group stopped accepting investor funds and voluntarily place itself into administration. ASIC issued multiple notices to Theta under s33 of the ASIC Act and s912C of the Corporations Act, responses to which were received over April and May 2018.
- 104 In total, ASIC received more than six thousand documents from external parties in relation to the Sterling Income Trust. ASIC also wrote to Sterling regarding misleading statements on the Sterling website.
- 105 Theta and the Sterling Group were aware that ASIC had concerns about ongoing sales interests in the Sterling Income Trust, especially to new clients. On 30 April 2018, as ASIC’s actions continued, Theta withdrew its last PDS for units in the Sterling Income Trust. At this point, ASIC had begun considering whether there was sufficient evidence to press for a winding up of the Sterling Income Group.

## **Winding up of the scheme and group (May 2018 onwards)**

- 106 ASIC’s investigation continued. In May 2018, ASIC was in regular and ongoing contact with WA DMIRS in relation to Sterling, and reviewed a large volume of documents provided both in response to ASIC notices and voluntarily.
- 107 In June 2018, ASIC met in person with Theta, Sterling, and their solicitor, as well as conducting interviews with SNLL tenant-investors. By July 2018, ASIC had squarely raised the issue of appointing liquidators via court order to the Sterling Income Trust; Theta argued that this would not be in the best interests of unit holders due to high costs.
- 108 ASIC does not have the power to appoint a liquidator to a managed investment scheme in distress, nor to direct a responsible entity to do so. Possible law reforms in relation to managed investment schemes in distress were discussed in ASIC’s initial submission at paragraph 238—240.
- 109 On 8 August 2018, ASIC confronted Theta and the Sterling Income Trust’s auditors on issues including the impact on elderly investors who relied on returns to pay their lease payments, as well as strongly pressing ASIC’s concerns regarding whether the Sterling Income Trust was an economically viable offering. On 15 August 2018, Theta advised ASIC it intended to wind up all the Sterling Income Trust’s unit classes.

- 110 The winding up of the Sterling Income Trust process began on 27 August 2018. In October 2018, Sterling and Theta assured ASIC that SNLL tenant-investors would be made whole. The winding up process is continuing, but as Theta is itself now in liquidation, the winding up of the Sterling Income Trust is being carried out by the liquidator of Theta.
- 111 The current framework in the Corporations Act does not allow for ASIC to appoint a temporary responsible entity where ASIC reasonably considers it is necessary or where the responsible entity is insolvent, and does not provide for liquidation of a managed investment scheme directly.
- 112 In December 2018, when it became clear that the Sterling Group had raised funds from SNLL investor-tenants by offering redeemable preference shares in Silverlink companies, ASIC worked quickly and forcefully to end that fundraising, including considering whether an application for a s1324 Corporations Act injunction was required.
- 113 The lack of a disclosure document in relation to shares in Silverlink companies made that swift action possible (in contrast with the Sterling Income Trust, which despite its shortcomings conducted its activities as a registered managed investment scheme and under the control of a licensed responsible entity). 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.
- 114 ASIC continued to press Theta and the Sterling Group, including a full-day compulsory examination (s19 examination under the ASIC Act) of one of the officers in December 2018, another full day compulsory examination of a second officer and four days of compulsory examinations of a third officer in March 2019. One officer's hard drive relating to the Sterling Group was also taken by ASIC.
- 115 ASIC asked for and received updates from Theta and the Sterling Group in relation to the winding up, the status of financial accounts, and how any shortfalls with investor-tenants would be rectified.
- 116 In March 2019, the Sterling Group engaged Ferrier Hodgson to conduct a cashflow and solvency review of the company, and ASIC sought and obtained updates on this process.
- 117 In April 2019, ASIC briefed counsel in relation to an application to appoint provisional liquidators, receivers, freezing orders and winding up of Sterling Group entities. On 3 May 2019, having been told by ASIC that the court application was imminent, voluntary administrators were appointed to the Sterling Group. The Sterling Group has been in liquidation since 10 June 2019 and this is ongoing.
- 118 A longer and detailed chronology is out in Section D of ASIC's initial submission.



## Key terms

Term	Meaning in this document
AFCA	Australian Financial Complaints Authority
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services  Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act  Note: This is a definition contained in s761A.
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i> (Cth)
CDPP	Commonwealth Department of Public Prosecutions
Ch 7 (for example)	A chapter of the Corporations Act (in this example numbered 7)
Corporations Act	<i>Corporations Act 2001</i> (Cth), including regulations made for the purposes of that Act
Corporations Regulations	<i>Corporations Regulations 2001</i> (Cth)
financial services business	A business of providing financial services  Note: This is a definition contained in s761A of the Corporations Act. The meaning of 'carry on a financial services business' is affected by s761C.
managed investment scheme	A managed investment scheme that is registered under s601EB of the Corporations Act
Product Disclosure Statement (PDS)	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act.  Note: See s761A for the exact definition.
registered scheme	A managed investment scheme that is registered under s601EB of the Corporations Act
responsible entity	Has the same meaning as in s9 of the Corporations Act.  For a registered scheme, means the company named in ASIC's record of the scheme's registration as the responsible entity or temporary responsible entity of the scheme



Term	Meaning in this document
retail client	A client as defined in s761G of the Corporations Act and associated Corporations Regulations
RG 134 (for example)	An ASIC regulatory guide (in this example numbered 134)
s601EB (for example)	A section of the Corporations Act (in this example numbered 601EB), unless otherwise specified
Silverlink companies	Silverlink Investment Company Limited and Silverlink Securities Pty Ltd
Silverlink Investment Company Limited	Silverlink Investment Company Limited ACN 623 500 407
Silverlink Securities Pty Ltd	Silverlink Securities Pty Ltd ACN 622 598 823
SNLL	Sterling New Life Lease
SNLL tenant-investors	Investors in the Sterling Income Trust who entered into an SNLL (see also 'Sterling Income Trust tenant-investors')
Sterling Group	Established in 2010 and comprised around 50 companies and trusts centred around real estate-related assets.  Note: See Appendix 1 of ASIC's initial submission for a diagram of the group's structure.
Sterling Income Trust	A registered managed investment scheme established in 2012 named the Sterling Income Trust, ARSN 158 828 105
Sterling matter	The collapse of Sterling Group and Sterling Income Trust
Theta	Theta Asset Management Ltd ACN 071 807 684
WA DMIRS	Western Australia Department of Mines Industry Regulation and Safety (Consumer Protection Division)
Wallis Inquiry	Financial System Inquiry (1996)