Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

2014 - 2015

Department/Agency: ASIC
Question: BET 104
Topic: Forced Sales
Reference: written - 10 June 2015
Senator: Williams, John

Question:

104. In the case of Gippsland Secured Investments, the company returned over 90 cents in the dollar to investors after having paid the liquidators and the Trust Company (Trustee) fees and recovered loan funds by forced sales of property that was held as security for loans. GSI's liabilities exceeded their assets where their assets were valued on instructions as forced sales. Properties were sold at prices significantly higher than valuations, yet the Trustee relied on these valuations to close GSI down.

What is ASIC doing to protect secured note-issuing companies and investing-debenture holders from similar outcomes with companies that are still viable and operating?

Answer:

Two issues are raised in relation to (1) GSI's financial position and (2) ASIC's role in this sector.

1. GSI's Financial Position

As ASIC understands the position it is expected that GSI Note Holders will receive up to 89 cents in the dollar (not over 90 cents in the dollar) following the realisation of the assets of GSI by its Receivers and Managers.

The receivers and managers were appointed by GSI's Trustee (The Trust Company) on 3 September 2013 on the basis of concerns that GSI's equity and loan asset impairment provisions were insufficient. Both the Trustee and the Federal Court carefully considered GSI's financial position before this step was taken.

In November 2012 The Trust Company engaged in an extensive review of GSI's operations to assess whether GSI had sufficient assets to continue to meet its obligations to note holders, which included the appointment of an independent expert.

The Trustee found (and the receivers later agreed) that GSI's equity and liquidity reached critical lows in mid-2013. As at 31 December 2012, GSI's equity ratio was 3.94% of its liabilities (versus the standard benchmark of 8% and a benchmark of 20% where funds are used for property development, as set out in ASIC guidance). In the 2012 Financial Year, GSI made a loss of $1,340,953 and in the half year to January 2013 a loss of $63,084. On 19 July 2013, GSI froze redemptions which resulted in an event of default under the trust deed.

On 25 July 2013, The Trust Company successfully applied to the Federal Court for orders to freeze payments to note holders and that GSI not make any payments to related parties.

At the time of the court action, GSI itself recognised a net tangible asset shortfall of $3.8 million. A substantial proportion (~ $23M out of a total $150M) of GSI's notes were 'at call'. The company did not maintain sufficient liquidity to meet their 'at call' obligations. Aside from cash holdings, nearly all assets were illiquid (principally long-term loans and a small amount of real property). At the time that receivers were appointed, a large proportion of the loan book (~50%) was in default. Of the remaining 50%, a substantial proportion were interest-capitalising loans (i.e. not in default, but not producing any income).

2. *ASIC's role in this sector*

ASIC has previously conducted a review of the unlisted debenture market and continues to monitor a number of issuers in the sector and the practices of debenture trustees. ASIC has asked trustees, as a 'gatekeeper' in the market, to actively monitor issuers where they have concerns and consider how information is communicated to investors making investment decisions about debentures. Where necessary ASIC takes active steps, including appearing at Court, to ensure that investors interests are protected.

We consider that s283DA of the Corporations Act implicitly requires a trustee to exercise reasonable diligence to regularly assess and form an opinion on an issuer’s financial position, performance and viability.
If an issuer experiences financial difficulties, the trustee plays a key role in ensuring the equal treatment of investors by applying to the court to freeze new issues and redemptions.
48 Section 283DA requires the trustee to:
(a) exercise reasonable diligence to ascertain whether the property of the borrower and each guarantor will be sufficient to repay the amount deposited or lent when it falls due; and
(b) exercise reasonable diligence to ascertain whether the borrower or any guarantor is in breach of the terms of the debentures, the provisions of the trust deed or Ch 2L.

Although the appointment of Receivers and Managers is a matter for Trustees, ASIC acknowledges that establishing whether a debenture issuer has sufficient to repay debentures may be difficult to assess. ASIC's view is that protection of investor interests and ensuring equality of treatment is extremely important. The risk of enforcing a Trust Deed prematurely needs to be balanced against the risk of a company’s financial position deteriorating further, with the result that some investors will receive 100% return while others will find their return seriously diminished.

Other Comments

ASIC commenced an investigation in March 2014 against GSI's auditor, Ms Loh. This investigation was commenced based on concerns that the 2011 and 2012 audits of GSI had not been conducted in accordance with Australian Auditing Standards. In December 2014 Ms Loh offered an Enforceable Undertaking to ASIC whose terms included that her registration as an auditor would be cancelled and she would never apply for re-registration.