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Dear Committee Secretary

**SUBMISSION TO THE REVIEW OF THE REGULATORY FRAMEWORK FOR MANAGED INVESTMENT SCHEMES**

As the Minister for Commerce, issues impacting consumers in Western Australia fall within my portfolio responsibilities, so I welcome this opportunity to make a submission on behalf of the Western Australian (WA) Government to the *Review of the Regulatory framework for Managed Investment Schemes* (the Review).

**Background**

My Commerce portfolio includes oversight of a range of legislation that regulates individuals and companies in WA including those involved in the residential property industry.

The Department of Mines, Industry Regulation and Safety – Consumer Protection Division (Consumer Protection) is responsible for undertaking regulatory functions under the legislation that applies to property related industries in WA, including (inter alia) residential tenancies and the real estate industry.

This submission does not seek to address specific questions referenced in the consultation paper but does raise the following key issues:

- i. The high risks involved for consumers, who are retired or approaching retirement, of legislation allowing complex group company structures to be established to operate managed investment schemes. These risks are higher where consumers invest significant funds in a managed investment scheme in exchange for non-proprietary interests in real property. The need for such arrangements to be regulated arises from the fact that many retired consumers may not have the time to recover financially if the scheme becomes insolvent

and so may not be able to obtain alternative long-term secure housing for their retirement<sup>1</sup>

- ii The discussion at section 2.4 of the consultation document about the need for regulators to be able to scrutinise and hold accountable those executives and other individuals managing transactions undertaken by the group of companies in the operation of managed investment schemes.
- iii. The question raised at section 7.4 of the consultation document about the need for regulators to take a collaborative information sharing approach in using Commonwealth and State laws to regulate managed investment schemes

### **Managed investment schemes combined with offers of non-proprietary interests in real property<sup>2</sup>**

Managed investment schemes carry significant risks for consumer investors or tenants (especially retired consumers<sup>3</sup>) where a non-proprietary interest in real property is conferred, which takes the form of a condition or benefit. For example, a tenancy for life with the commitment that income generated by the tenant's significant contribution to a managed investment scheme would pay the rent.

These risks were highlighted by the Senate Economics References Committee's (Senate Committee) inquiry into the collapse of the Sterling Group (Inquiry), which detailed the significant financial, social and psychological costs that flowed from the failure of that high risk offering.

Consumer Protection has been at the frontline of the WA Government's response to the collapse of the Sterling Group, and I support its view that managed investment schemes provided in combination with the conferral of non-proprietary interests in real property should be prohibited outright. If not prohibited, such schemes should be subject to more robust scrutiny by The Australian Securities and Investments Commission (ASIC) so that particular combinations of complex financial and non-financial products that require consumers to invest significant monies can be refused by ASIC under the *Corporations Act 2001 (Cth)* (the Corporations Act).

### **The roles and obligations of responsible entities, directors, and associates**

The financial products scrutinised in the wake of the collapse of the Sterling Group revealed that the directors and other key executives had a history of failed business ventures.<sup>4</sup>

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<sup>1</sup> Senate Economics References Committee inquiry into Sterling Income Trust, February 2022, page 50, paragraph 4.50

<sup>2</sup> See discussion in Chapter 2 of the consultation paper

<sup>3</sup> Senate Economics References Committee inquiry into Sterling Income Trust, February 2022, page 50, paragraph 4.50

<sup>4</sup> Senate Economics References Committee inquiry into Sterling Income Trust, February 2022, page 64, paragraph 4.107

Further, it was apparent that the responsible entity administering the Sterling Group scheme did not exercise active or effective control over the directors of the subsidiary companies managing the different components of the Group's operations, such as property management services and property development aspects

With my support, Consumer Protection proposes that, in the wake of the collapse of the Sterling Group, existing "fit and proper person" requirements under the Australian financial services licensing regime should be extended to those officers controlling or administering the responsible entity and to those directors of each subsidiary company within the group. Fit and proper requirements should also apply to close associates of the directors who exert influence over the conduct of the responsible entity in the context of the relevant managed investment scheme. Close associates would include third party promoters or representatives of the scheme

Further, and with my support, Consumer Protection proposes that consideration be given to extending ASIC's powers, including with respect to director's duties provisions under the Corporations Act, to applying a chain of responsibility to the group so that regulatory action (including public naming and banning of repeat offenders) can be taken against those directors of companies within the group that have a legislative responsibility for the actions of other directors within a group of companies who contravene the law

### **Interactions between Commonwealth and State laws when regulating real estate investments by managed investment schemes<sup>5</sup>**

I acknowledge that the Commonwealth is directly responsible for the regulation of managed investment schemes via the Corporations Act and the *Australian Securities and Investments Commission Act 2001* (Cth).

Whilst the State Government has no direct role in the regulation of managed investment schemes, it does have a role in the regulation of the industries in which such schemes may operate, especially those that involve the conferral of property rights or interests (leasehold or freehold).

In this context, Consumer Protection regulates.

- the licensing of real estate agents via the *Real Estate and Business Agents Act 1978* (WA) This included regulation of the real estate licence of Sterling Group company, Sterling First Projects Pty Ltd; and
- the terms of residential tenancy agreements via the *Residential Tenancies Act 1987* (the RT Act), including the enforcement of

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<sup>5</sup> See discussion in Chapter 7 of the Consultation paper

restrictions on what consideration can be required under a residential tenancy agreement and the limits on tenancy bond requirements.

I am advised that each of the above regulatory functions were utilised by Consumer Protection in its initial investigation of the Sterling Group. Additionally, it should be noted that these were the only functions that Consumer Protection (and the State Government) could use to regulate the activities of the Sterling Group.

I am advised that Consumer Protection, in its role as regulator of property-related industries, and its continued enforcement of the Australian Consumer Law (WA), is looking at options to amend the RT Act to clarify the prohibition on the soliciting of lump sum payments from tenants that fall outside the limits set for rent or bond payments.

Whilst these reforms will go some way to inhibiting the establishment of schemes like that offered by the Sterling Group in the future, the question of how a scheme with a significant risk of failure was able to make a retail offering, particularly to a vulnerable group of older prospective investors (as was predominantly the case with the Sterling Group) remains to be answered. This may suggest a gap in the regulatory arrangements that apply to managed investment schemes (Commonwealth jurisdiction) and the regulation of licenced entities that deal in property transactions (state jurisdiction) such as the one operated by the Sterling Group.

In response to the question in section 7.4, I propose that further work needs to be done to identify potential gaps arising from the dual regulatory arrangements. This could for example be achieved by the Commonwealth working with its State and Territory counterparts to clarify jurisdictional overlap between Commonwealth and State/Territory legislation to better identify options for regulators to proactively prevent the harms caused to consumers who invested in the Sterling Group's managed investment scheme.

Thank you for the Committee's consideration of this submission.

Yours sincerely



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