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Submission to Senate Economics References Committee  
**Sterling Income Trust**

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NOVEMBER 2021

## About Us

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Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most. To find out more about CHOICE's campaign work visit [www.choice.com.au/campaigns](http://www.choice.com.au/campaigns)

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## INTRODUCTION

CHOICE welcomes the inquiry by the Senate Economics References Committee (**‘the Committee’**) into the collapse of the Sterling Group.

The Sterling Group collapse<sup>1</sup> has caused homelessness and severe financial hardship for retirees and pensioners across the country. The people affected lack avenues to seek compensation. The government must act so that the Sterling victims and victims of similar financial misconduct in the future have access to compensation.

CHOICE recommends the Federal Government’s proposed compensation scheme of last resort (**‘CSLR’**) be expanded to include managed investment scheme collapses. A broad-based, industry-funded CSLR that includes managed investment schemes will allow most Sterling Group victims to access compensation.

Some people impacted by the Sterling Group collapse, including people who purchased the Silverlink product, may not be eligible for compensation through a broad-based CSLR. For these people, we recommend the Committee investigate alternative means of compensation.

The Committee is tasked with inquiring into legislative and regulatory reform to prevent such losses in the future. If we fail to learn the lessons of the collapse of Sterling Group there is a strong risk that similar scandals will eventuate, with many more people suffering financial loss as the result of misconduct. The Australian Securities and Investments Commission (**‘ASIC’**) needs to be empowered to act quickly to respond to the threats of managed investment scheme collapses. Regulatory delay can contribute to further consumer hardship with more consumers being persuaded to invest in harmful products and existing consumers being unaware of their options to exit.

ASIC needs to be a more proactive and responsive regulator. CHOICE recommends that ASIC use its full suite of regulatory tools including issuing timely public warning notices as soon as early reports of misconduct emerge. ASIC should also use its new product intervention powers to intervene when harmful products such as managed investment schemes emerge or when the sales practice associated with particular managed investment schemes create risk of harm to consumers. We recommend that ASIC be granted a new directions power to compel a financial services licensee to change its conduct, including preventing it from taking on new clients. This is a key recommendation of the ASIC Enforcement Review and the Banking Royal Commission. It will give ASIC more flexibility in responding to emerging risks in the financial sector.

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<sup>1</sup> In this submission, ‘the Sterling Group collapse’ means the collapses of the Sterling Income Trust, Theta Asset Management Ltd, Silverlink Securities, the Silverlink Investment Company and all associated entities.

## Recommendations

### **Recommendation 1**

The Federal Government should establish a broad-based compensation scheme of last resort that includes managed investment scheme collapses.

### **Recommendation 2**

The Senate Economics Committee should investigate and recommend avenues of redress for all victims of the Sterling Group collapse. This may include:

- compensation through the once-off levy on the ten largest financial firms;
- compensation for defective administration; or
- a lump-sum payment provided by the Federal Government.

### **Recommendation 3**

ASIC should use its public warnings power to quickly alert consumers about emerging risks of managed investment schemes. ASIC should develop a framework for ensuring early identification of consumer harm through managed investment schemes to ensure that the regulator issues early and quick public warnings when appropriate.

### **Recommendation 4**

ASIC should use its new product intervention powers to take timely action against harmful managed investment scheme products.

### **Recommendation 5**

The Federal Government should legislate a directions power for ASIC.

## 1. Access to compensation for Sterling Group victims

CHOICE strongly supports victims of the Sterling Group collapse receiving compensation for any losses incurred as the result of mis-selling and misconduct by the operators of businesses that were part of the Sterling Group. For most people, this will be achieved by expanding the Government's proposed compensation scheme of last resort to include managed investment scheme ('MIS') collapses. For those who will not be captured by the expanded CSLR, the Senate Economics Committee should examine and recommend alternative methods of compensation.

### Expand the CSLR to include managed investment scheme collapses

CHOICE supports the inclusion of MIS in the scope of the Government's proposed compensation scheme of last resort.

The Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021 establishing the CSLR was introduced into the House of Representatives in October 2021.<sup>2</sup> The proposed scope of the scheme is too narrow and will only apply to the following five financial products and services:

1. personal advice on relevant financial products to retail clients;
2. credit intermediation;
3. securities dealing;
4. credit provision; and
5. insurance product distribution.<sup>3</sup>

People impacted by managed investment scheme collapses including the Sterling Group are excluded from the current scope of the CSLR. This is disappointing for Sterling Group victims who have been told on over 40 occasions by Government ministers, politicians, and regulators to lodge complaints at the Australian Financial Complaints Authority ('AFCA') on the assumption that this avenue will provide the victims with compensation.<sup>4</sup> Whilever the CSLR does not include MIS collapses, AFCA will not progress complaints by Sterling Group victims.

The Commonwealth Treasury identified 'evidence of uncompensated losses' as a key consideration in designing the scope of the CSLR.<sup>5</sup> CHOICE supports the scheme being targeted to areas where there is the greatest evidence of harm for uncompensated losses. There is historical evidence of unpaid determinations in collapses of managed investment

<sup>2</sup> Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021

<sup>3</sup> Treasury, 2021, Compensation Scheme of Last Resort (CSLR) - Proposal Paper, <https://treasury.gov.au/consultation/c2021-186669>

<sup>4</sup> Sterling First Action Group, August 2021, Submission to Treasury, Compensation Scheme of Last Resort – Consultation Process

<sup>5</sup> Treasury, 2019, Implementing Royal Commission Recommendation 7.1 – Establishing a Compensation Scheme of Last Resort, p.6 [https://treasury.gov.au/sites/default/files/2019-12/191220\\_cslr\\_discussion\\_paper.pdf](https://treasury.gov.au/sites/default/files/2019-12/191220_cslr_discussion_paper.pdf)

schemes including the collapse of Sterling Group that have left families uncompensated. The Ramsay Review found that operators of managed investment schemes were the second highest category of non-compliant financial firms at the Financial Ombudsman Service (FOS).<sup>6</sup>

AFCA also acknowledged that there are unpaid determinations for the managed investment scheme industry.<sup>7</sup> In April 2020, AFCA announced it had stopped processing complaints against insolvent firms. However, AFCA had already begun awarding determinations in favour of consumers in matters involving the Sterling Group before this decision was made. For example, on 31 March 2020 AFCA awarded \$118,957.60 to a complainant in relation to misleading and deceptive conduct of the Sterling Income Trust.<sup>8</sup> It is a disillusioning experience for victims who have been subject to similar conduct by the Sterling Group to see historical determinations for compensation having been awarded, only for them to now be excluded from accessing justice and compensation.

The Government's rationale for excluding managed investment schemes is seemingly the assumption that including MIS collapses in the scheme risks creating a moral hazard. We disagree with this assumption. The Ramsay Review thoroughly considered the risks of moral hazard for a CSLR and concluded, "the Panel does not consider that the risks of moral hazard in the instance of establishing a CSLR have been substantiated."<sup>9</sup> The Ramsay Review found there is a "very small risk" of a moral hazard given there are other significant disincentives and protections in place, such as:

- "a firm which does not have compensation arrangements is in breach of the financial services laws and could be subject to regulatory and enforcement action by ASIC;
- there are a number of regulatory improvements underway or that have been undertaken in recent years to improve the professionalism and quality in financial advice;
- consumers are generally unable to assess a financial firm's compliance history or identify which firms are more likely to become insolvent; and
- for a consumer or small business to access a CSLR, they need to first suffer a loss and then spend considerable time going through the dispute resolution process, which involves uncertainty for consumers and small businesses about whether they will be successful"<sup>10</sup>.

In fact, a strong case can be made that rather than creating a moral hazard, the establishment of a CSLR would improve industry conduct. Responsible firms will want to ensure that the scheme is called on as rarely as possible and will have an incentive to improve industry conduct and report non-compliant businesses to regulators.

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<sup>6</sup>Ramsay Review, 2017, 'Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report', pg 40

<sup>7</sup>AFCA, 2020, 'Submission to Treasury Consultation on a Compensation Scheme of Last Resort', p.3

<sup>8</sup>AFCA Case Number 667682

<sup>9</sup>Ramsay Review, 2017, 'Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report', pg 49

<sup>10</sup> Ramsay Review, 2017, 'Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report', pg 49

## Recommendation 1

The Federal Government should establish a broad-based compensation scheme of last resort that includes managed investment scheme collapses.

### Compensation for victims not captured by a broad-based CSLR

CHOICE understands that some Sterling Group victims will be excluded from receiving compensation from the CSLR even if managed investment schemes are included in the scope of the scheme. This includes some people who were sold the Silverlink product through Libertas Financial Planning.<sup>11</sup> As a result of *DH Flinders Pty Limited v Australian Financial Complaints Authority Limited* [2020] NSWSC 1960, 15 of the 19 complaints against Libertas Financial Planning are now outside of AFCA's rules and the scope of a broad-based CSLR. The Committee should investigate and propose alternative means of compensation for people excluded from an expanded CSLR (that includes MIS collapses). This will ensure that all victims of the Sterling Group collapse have fair access to redress. Possible avenues of redress for victims may include:

- **Compensation through the once-off levy on the ten largest financial firms.** The Federal Government has proposed a once-off levy to pay for 'accumulated unpaid determinations'.<sup>12</sup> This once-off levy would be applied to the ten largest financial firms in Australia. All Sterling Group victims could receive compensation through this once-off payment.
- **Compensation for defective administration.** A compensation scheme exists for loss suffered as a result of negligence or defective administration from a Commonwealth agency.<sup>13</sup> This is an "administrative scheme established to allow Australian Government agencies to provide compensation where there is a moral rather than a legal obligation to do so."<sup>14</sup> If the Senate Economics Committee finds that any act or omission by ASIC contributed to economic loss by victims of Sterling Group, the Committee could recommend that victims receive compensation for defective administration.
- **Federal Government lump-sum payment.** The Senate Economics Inquiry could propose that the Federal Government compensate victims of Sterling Group with a once-off payment. This special payment could reflect that victims of the Sterling Group collapse have been misled about coverage in the proposed CSLR for a number of years.

<sup>11</sup>AFCA, 2021, Sterling group investors, October update, <https://www.afca.org.au/news/current-matters/sterling-group-investors>

<sup>12</sup> Commonwealth Treasury, July 2021, Compensation Scheme of Last Resort: Proposal Paper [https://treasury.gov.au/sites/default/files/2021-07/186669\\_compensationschemeoflastresort-proposalpaper.pdf](https://treasury.gov.au/sites/default/files/2021-07/186669_compensationschemeoflastresort-proposalpaper.pdf)

<sup>13</sup> Commonwealth Ombudsman, Fact Sheet, Compensation for defective administration, [https://www.ombudsman.gov.au/\\_\\_data/assets/pdf\\_file/0026/35594/Compensation-for-defective-administration.pdf](https://www.ombudsman.gov.au/__data/assets/pdf_file/0026/35594/Compensation-for-defective-administration.pdf)

<sup>14</sup> Commonwealth Ombudsman, Fact Sheet, Compensation for defective administration, [https://www.ombudsman.gov.au/\\_\\_data/assets/pdf\\_file/0026/35594/Compensation-for-defective-administration.pdf](https://www.ombudsman.gov.au/__data/assets/pdf_file/0026/35594/Compensation-for-defective-administration.pdf)

Victims have been told on 40 occasions by Government ministers, politicians, and regulators to lodge complaints at the Australian Financial Complaints Authority, and have been promised compensation through the CSLR.<sup>15</sup>

## Recommendation 2

The Senate Economics Committee should investigate and recommend avenues of redress for all victims of the Sterling Group collapse. This may include:

- compensation through the once-off levy on the ten largest financial firms;
- compensation for defective administration; or
- a lump-sum payment provided by the Federal Government.

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<sup>15</sup> Sterling First Action Group, August 2021, Submission to Treasury, Compensation Scheme of Last Resort – Consultation Process



## 2. Empower ASIC to be a more proactive and responsive regulator

This Senate Inquiry should address how ASIC can more quickly respond to, and address, emerging consumer harms caused by managed investment schemes.

### ASIC should use public warnings to quickly alert consumers about emerging risks of managed investment schemes

ASIC has the power to issue public warning notices about the conduct of persons in relation to financial services.<sup>16</sup> ASIC did not issue a public warning about risks in the Sterling Group. If this power had been used promptly, it may have prevented more people from signing up to products sold by the Sterling Group.

CHOICE recommends that ASIC issue public warning notices more frequently to alert consumers about emerging harms in the financial sector, especially in relation to managed investment schemes. A public warning power is a useful regulatory tool that can be deployed quickly to help prevent further consumer detriment from occurring. We recommend that ASIC use this tool as a first step while the regulator considers other regulatory options, including litigation.

Under the *Australian Securities and Investments Commission Act 2001* (Cth), ASIC may issue to the general public a written notice containing a warning about the conduct of a person if it:

- a) has reasonable grounds to suspect that the conduct may constitute a breach of a financial services law; and
- b) is satisfied that one or more other persons has suffered, or is likely to suffer, detriment as a result of the conduct; and
- c) is satisfied that it is in the public interest to issue the notice.<sup>17</sup>

According to the ASIC's register, the corporate regulator has issued public warnings on 11 occasions since May 2012<sup>18</sup> but these have not included any public warnings about managed investment schemes.

ASIC should develop a framework for ensuring early identification of consumer harm through managed investment schemes to ensure that the regulator issues early and quick public warnings when appropriate. This framework should include key trigger points when ASIC should consider issuing warnings.

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<sup>16</sup> *Australian Securities and Investments Commission Act 2001*, s12GLC

<sup>17</sup> *Australian Securities and Investments Commission Act 2001*, s12GLC(1)

<sup>18</sup> Australian Securities and Investments Commission, 2021, Public warning notices, <https://asic.gov.au/online-services/search-asic-s-registers/additional-searches/public-warning-notices/>

Commonwealth and state consumer agencies provide a useful model of how timely public warning notices can mitigate consumer harm. In its regulatory guide, Australian consumer law regulators say it is appropriate to issue warnings when “there is an imminent or ongoing risk of consumer detriment.”<sup>19</sup> In order to reach the wider Australian community, consumer law regulators suggest sharing public warnings through media releases, social media posts, as well as being posted on regulators websites. This can help inform the general public about the risks of a certain consumer product or service before a regulator takes legal action against an operator.

As an example, there were mounting and serious safety concerns with a Thermomix kitchen appliance coming to light in 2013. The model had a faulty sealing ring on its mixing bowl that had led to widespread scalding of consumers. In 2014, the ACCC issued a consumer warning and product recall of the kitchen appliance.<sup>20</sup> In 2018, Thermonix was fined \$4.6 million by the Federal Court of Australia for breaching the Australian Consumer Law.<sup>21</sup> By warning the general public, the ACCC was able to respond to the harm before commencing legal action against the company.

In many respects, a harmful consumer product is analogous to a harmful financial product; both can cause serious and lasting impacts on the lives of consumers and their families. We recommend that ASIC learn from Commonwealth and state consumer agencies and issue early public warnings about managed investment scheme collapses. This may prevent new people from signing up to a harmful managed investment scheme.

### Recommendation 3

ASIC should use its public warnings power to quickly alert consumers about emerging risks of managed investment schemes. ASIC should develop a framework for ensuring early identification of consumer harm through managed investment schemes to ensure that the regulator issues early and quick public warnings when appropriate.

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<sup>19</sup> Australian Consumer Law, 2012, Public warning notices guide  
<https://www.commerce.wa.gov.au/sites/default/files/atoms/files/acipublicwarningnoticesguide.pdf>

<sup>20</sup> Product Safety, 2014, Vorwerk Elektowerke GmbH & Co. KG—Thermomix TM31 Sealing Ring,  
<https://www.productsafety.gov.au/recalls/vorwerk-elektowerke-gmbh-co-kg%E2%80%94thermomix-tm31-sealing-ring>

<sup>21</sup> Australian Competition & Consumer Commission, 2018, Thermomix ordered to pay penalties of more than \$4.6 million,  
<https://www.accc.gov.au/media-release/thermomix-ordered-to-pay-penalties-of-more-than-46-million>

## ASIC should use its new product intervention powers to address emerging managed investment scheme risks

Since the collapse of Sterling Group, the Federal Government has granted ASIC new powers to respond more quickly to the threat of harmful financial products, including managed scheme products. This new product intervention power ('PIP') allows ASIC to take temporary action where it is satisfied that a financial product/s 'have resulted in, or are likely to result in' significant consumer detriment'.<sup>22</sup> The PIP is broad: ASIC is able to consider a wide range of factors and tailor a product intervention order accordingly. The PIP is also a more timely regulatory option than pursuing litigation, especially when the risk of consumer harm develops quickly.

The PIP has been designed as a flexible addition to ASIC's regulatory toolkit. ASIC says this new power will allow it 'to respond in a flexible, targeted, effective and timely way'.<sup>23</sup> Since the new powers came into effect in 2019, ASIC has not used its product intervention powers to address harmful managed investment scheme products. We recommend that ASIC use the new PIP to address emerging managed investment scheme risks when they emerge.

### Recommendation 4

ASIC should use its new product intervention powers to take timely action against harmful managed investment scheme products.

## ASIC should be granted a legislated directions power

CHOICE supports ASIC having the power to give directions to financial services and credit licensees. This 'directions power' would help ASIC address or prevent emerging risks to consumers. A directions power remains a missing link in ASIC's existing regulatory toolkit. ASIC will be able to become a more proactive and effective regulator if it has a directions power.

This power was a key recommendation of the ASIC Enforcement Review and the Banking Royal Commission.<sup>24</sup> The Enforcement Review found:

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<sup>22</sup> ASIC, 2020, RG 272 Product intervention power, p.16

<sup>23</sup> ASIC, 2020, RG 272 Product intervention power, p.4

<sup>24</sup> ASIC Enforcement Review Taskforce, 2017, Recommendations 46-50  
<https://treasury.gov.au/sites/default/files/2019-03/ASIC-Enforcement-Review-Report.pdf>

*“a directions power could enable ASIC to direct the licensee to take urgent action that may be necessary to protect clients’ interests...Such a power will provide ASIC with an efficient mechanism to require a licensee to put in place or modify internal systems or restrict activities in appropriate ways to prevent detriment to consumers.”<sup>25</sup>*

In February 2020, the Federal Government released draft legislation to provide ASIC with a directions power.<sup>26</sup> CHOICE strongly supports the passage of this legislation. However, the bill is yet to be introduced into Parliament. The bill states ASIC may make a direction if there is “reason to suspect that a financial services licensee has engaged, or is engaging, in conduct that constitutes a contravention of a financial services law.”<sup>27</sup> The bill has a non-exhaustive list of directions that ASIC could make. This includes directing a financial services licensee to not accept new clients or not transfer a specified asset to another person, or to compel a licensee to undertake a review of their conduct. For example, a directions power would have allowed ASIC to quickly direct the Sterling Group to stop accepting new clients.

The ASIC Enforcement Review also found that the product intervention powers and directions power are regulatory options that will complement each other.<sup>28</sup> The PIP’s focus is on stamping out poor financial products, while the directions power is broader and will be focused on regulating licensee conduct.

## Recommendation 5

The Federal Government should legislate a directions power for ASIC.

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<sup>25</sup> ASIC Enforcement Review Taskforce, 2017, p.103, <https://treasury.gov.au/sites/default/files/2019-03/ASIC-Enforcement-Review-Report.pdf>

<sup>26</sup> Financial Sector Reform (Hayne Royal 4 Commission Response—Stronger 5 Regulators (2020 Measures)) Bill 2020: 6 FSRC rec 7.2 (ASIC directions)

<sup>27</sup> Financial Sector Reform (Hayne Royal 4 Commission Response—Stronger 5 Regulators (2020 Measures)) Bill 2020: 6 FSRC rec 7.2 (ASIC directions), s918

<sup>28</sup> SIC Enforcement Review Taskforce, 2017, p.103, <https://treasury.gov.au/sites/default/files/2019-03/ASIC-Enforcement-Review-Report.pdf> -