M101 HOLDINGS PTY LTD

MEMORANDUM OF ADVICE

1. I am asked to advise M101 Holdings Pty Ltd ("**M101**") with regard to a number of issues arising out of a proposal by M101 to issue Promissory Notes. Specific questions that were asked in my brief are addressed below under the corresponding headings to the questions in section 4.1 and following of my brief.

Background

2. M101 is a part of the IPO Wealth Group ("**IPO Wealth**"). IPO Wealth has a substantive presence in the Australian financial market and provides a range of term based investment products to wholesale investors. IPO Wealth transacts its business by a unit trust. Those units have rights attached to them including the relevant interest rate and date of redemption.

3. The funds raised by IPO Wealth are then on-lent to a related party, IPO Wealth Holdings Pty Ltd t/a Mayfair 101 Holdings. The advance to Mayfair 101 is made at a higher rate of interest (10% per annum) than that which is paid by IPO Wealth to its investors (approximately 6% per annum). The funds thus on-lent to Mayfair 101 are then used by it to invest in a range of private equity investments. Those investments in turn generate sufficient returns to enable Mayfair 101 to pay IPO Wealth the 10% return on the funds invested. IPO Wealth is then able to meet its interest payments to its individual investors.

4. In 2018 ASIC sought the production of documents from IPO Wealth and raised concerns with it about the nature of advertising undertaken by it. ASIC had some concerns as to whether or not the business activities and/or advertising of IPO Wealth was properly compliant with the provisions of the *Corporations Act*. I have not been instructed as to the detail of the ASIC concerns, but then nor is it relevant for the purposes of this advice, save for one issue.

5. Whilst I am instructed that as a consequence of the attention from ASIC, IPO Wealth made some amendments to its advertising program, no further issue or concern was expressed by ASIC. The matter was resolved to the satisfaction of ASIC. Nonetheless, in circumstances where M101 is a part of the IPO Wealth Group, and ASIC has previously scrutinised the group's compliancy, that group remains vigilant, and keen to ensure that the new venture involving

M101 is properly compliant with the *Corporations Act*. It is in that context that my advice has been sought.

Objective of the M101 Investment Program

6. Our client has identified a number of opportunities for fund raising within the Mayfair 101 Group. Many businesses within that existing portfolio have a requirement for additional working capital. In addition, interest has been expressed by individual investors who wish to increase their involvement in the business interests of Mayfair 101. As the funds raised through the IPO Wealth Fund are largely committed to an existing investment portfolio, an alternative and additional means of fundraising has been proposed.

7. It is in that context that M101 was incorporated so as to facilitate the raising of funds for the Mayfair 101 Group working capital needs. The funds so raised would then be exploited by M101 in a variety of ways including;

    a. Payment of operating costs of entities within the group which may be effected by M101 on lending the monies to other subsidiaries;
    b. Lending funds to IPO Wealth Holdings Pty Ltd to assist in liquidity management;
    c. Lending money to IPO Wealth Holdings Pty Ltd and other subsidiaries who in turn may on lend those funds to other companies within the group;
    d. Lending the funds to a specific lending business independent of M101 but in respect of which the IPO Wealth group already had a significant share holding.

8. The proposed means of raising funds is via the issue of Promissory Notes. Capital raising in this way is seen as advantageous on the part of IPO Wealth Group as it does not involve the dilution of equity in existing entities. Similarly, they are attractive to investors given the current low interest rates which are available in the Australian financial market.

9. I am instructed that at all times the Promissory Notes will be issued to wholesale clients[1] only and that M101 will take responsibility for ensuring that each subscriber of Promissory Notes qualifies as a wholesale client.

[1] As defined in s 761G *Corporations Act* 2001. See also s 761GA

Promissory Note Deed Poll

10. I have been provided with a draft Promissory Note Deed Poll ("**Deed Poll**"). The deed poll empowers M101 to create differing classes of notes which can then be issued to different investors. The classes may differ in terms of the period of time within which they may be redeemed and the rate of interest which is applicable. Notes are issued by M101 with the investors completing in the first instance an application form, which is itself a deed, and which is in turn countersigned by M101 to indicate its acceptance of the subscription.

11. The terms of the Deed Poll relevantly provide as follows;
    a. A "note" within the meaning of the Deed Poll is an unsecured redeemable Promissory Note issued or to be issued by the company under, and on an subject to the terms of, the Deed Poll;
    b. A note holder may assign or transfer a note with the written consent of the company[2]. The company is required to maintain a register in respect of each note issued by the company and the person whose name is entered in the register as the holder of a note is deemed to be the absolute owner of the note in all circumstances[3];
    c. Upon redemption of any notes the company shall pay to the note holder the total amount of moneys owing on those notes calculated as at the withdrawal date[4];
    d. Where the total amount payable in respect of the redemption of any notes is paid by the company then those notes will cease to exist and cease to be on issue[5];
    e. The notes are debt obligations of the company[6] and are unsecured Promissory Notes[7].

4.1 WHETHER THE PROMISSORY NOTES ARE DEBENTURES WITH THE MEANING OF THE CORPORATIONS ACT

Corporations Act

12. The *Corporations Act 2001* ("**CA**") defines a "debenture" in section 9 as follows;

> "***'debenture'*** of a body means a chose in action that includes an undertaking by the body to repay as a debt money deposited with or lent to the body. The chose in action

[2] Clause 8.1
[3] Clause 3.7
[4] Clause 5.5
[5] Clause 5.8
[6] Clause 3.5
[7] Clause 3.6

may (but need not) include a security interest over property of the body to secure repayment of the money. However, a debenture does not include:

(a) an undertaking to repay money deposited with or lent to the body by a person if:

(i) the person deposits or lends the money in the ordinary course of a business carried on by the person; and

(ii) the body receives the money in the ordinary course of carrying on a business that neither comprises nor forms part of a business of borrowing money and providing finance; or

(b) an undertaking by an Australian ADI to repay money deposited with it, or lent to it, in the ordinary course of its banking business; or

Note: This paragraph has an extended meaning in relation to Chapter 8 (see subsection 1200A(2)).

(c) an undertaking to pay money under:

(i) a cheque; or

(ii) an order for the payment of money; or

(iii) a bill of exchange; or

(d) *repealed*

(e) an undertaking by a body corporate to pay money to a related body corporate; or

(f) an undertaking to repay money that is prescribed by the regulations.

For the purposes of this definition, if a chose in action that includes an undertaking by a body to pay money as a debt is offered as consideration for the acquisition of securities under an off-market takeover bid, or is issued under a compromise or arrangement under Part 5.1, the undertaking is taken to be an undertaking to repay as a debt money deposited with or lent to the body."

13. Relevantly, for present purposes, the first part of the definition encapsulates the obligations contained within the note, namely **a chose in action which includes an undertaking by the company to pay as a debt money deposited with or lent to the company**. The remaining components of the section provide for certain exclusions. Subparagraph (c)(iii) provides that a debenture does not include an undertaking to pay money under a bill of exchange.

14. Previously, the definition of "debenture" also contained an exclusion at subparagraph (d) which then provided that a debenture does not include;

> "an undertaking to pay money under a Promissory note that has a face value of at least $50,000".

15. Whilst it seems attractive at first instance to consider that the removal of the exclusion in relation to a Promissory Note enlarges the remaining definition of "debenture", it does not follow as a matter of course that the continuing exclusion in respect of a bill of exchange under subparagraph (c)(iii) is not still operative in respect of a document which might otherwise be described as a Promissory Note.

Bills Of Exchange Act

16. Section 8 of the *Bills of Exchange Act 1909* (Cth) provides;

> 1. A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer.
>
> 2. An instrument which does not comply with these conditions, or which orders any act to be done in addition to the payment of money, is not a bill of exchange.
>
> 3. An order to pay out of a particular fund is not unconditional within the meaning of this section; but an unqualified order to pay, coupled with:
>   a. An indication of a particular fund out of which the drawee is to reimburse himself or herself, or a particular account to be debited with the amount; or
>
>   b. A statement of the transaction which gives rise to the bill;
>
> is unconditional.

17. Section 13 of the *Bills of Exchange Act* relevantly provides as to when bills are negotiable. Specifically,

> When a bill contains words prohibiting transfer, or indicating an intention that it should not be transferable, it is valid as between the parties thereto, but is not negotiable.

18. Schedule two to the Deed Poll provides for the form of the note certificate. The certificate provides;

> "The notes form part of an issue of notes in an aggregate principal amount of AUD dollars… the notes were issued with the benefit of the rights and subject to the

> restrictions contained in the Promissory note Deed Poll dated … entered into by the company and the application from of the note holder dated ….
>
> Unless specified otherwise, terms defined in the Promissory note Deed Poll and the application form have the same meaning in this certificate.
>
> For value received, the many promises to pay to the note holder the amounts payable in accordance with, and otherwise comply with the obligations contained in, the Promissory note Deed Poll."

19. By the creation of negotiable instruments the *Bills of Exchange Act* permits certain types of written instruments that contain enforceable promises to be transferred from one person to another so that the end recipient may enforce the promises made to the original acquirer. A cheque is the most common form of negotiable instrument but, subject to their terms, Promissory Notes may also be negotiable instruments where the original promisee can pass on the benefit of the promise to a third person. It is in that context that the instrument may be negotiated.

20. In *Glasscock v Balls* [8] the Court of Appeal determined that notwithstanding the fact that an underlying debt as between the original maker of a Promissory Note had been satisfied, the fact that the Promissory Note had been negotiated to third parties without notice of the prior transactions, meant that the original maker of the Promissory Note was still liable to pay on demand.

> "… the maker of the note, having issued it and allowed it to be in circulation as a negotiable instrument, is liable upon it to an endorsee for value without notice of anything wrong."

21. By reason of the provisions of clause 8 of the Deed Poll a note holder may only assign a note with the written consent of the company, which consent may be withheld by the company. The note is not negotiable within the meaning of the *Bills of Exchange Act*, but it does meet the definition of a bill of exchange as contained in section 8(1).

22. Section 89 of the *Bills of Exchange Act* provides;

> (1) A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or

[8] (1889) 24 QBD 13

determinable future time, a sum certain in money, to or to the order of a specified person, or to bearer.

(2) An instrument in the form of a note payable to marker's order is not a note within the meaning of this section unless and until it is indorsed by the maker.

(3) A note is not invalid by reason only that it contains also a pledge of collateral security with authority to sell or dispose thereof.

(4) A note which is, or on the face of it purports to be, both made and payable within Australasia is an inland note. Any other note is a foreign note.

23. Section 95 also provides that subject to the provisions otherwise contained in the part pertaining to Promissory Notes, that Part 2 of the Act, relating to bills of exchange, applies with necessary modifications to the provisions in relation to Promissory Notes.

24. With reference to sections 8 and 89 of the *Bills of Exchange Act* the differences between a Bill of Exchange and a Promissory Note become evident;

    a. A bill of exchange is an unconditional order addressed by one person to another which requires the person to whom it addressed to pay a sum to the order of a specified person or to a bearer;

    b. A Promissory note is an unconditional promise in writing made by one person to another whereby the maker agrees to pay a sum certain to the order of a specified person or bearer.

25. The *Corporation Legislation Amendment (Financial Services Modernisation Act 2009)* amended the definition by deleting subparagraph (d) in section 1 of the third schedule to that Act.

26. In those terms, the amendment of the definition of "*debenture*" within the CA so as to remove the exclusion in respect of a Promissory Note from subparagraph (d) is indicative of an intention by Parliament to remove that exclusion. The result is that the wider definition of Promissory Note, to the extent that it means a chose in action that includes an undertaking by the company to repay as a debt money deposited with or lent to it, then falls within the definition of "debenture".

27. If there were any doubt on what the removal of subparagraph (d) means it is put to rest by the explanatory memorandum that accompanied the Amending Act. The explanatory memorandum for the Bill when it was before Parliament provided relevantly that;

> "Debentures regulation; amendments are proposed relating to the harmonisation of the regulation of debentures and Promissory notes, and the creation of a debentures trustee register. The two proposed changes are as follows;
>
> - A Promissory note with a face value with at least $50,000 will now be included under the definition of a debenture. This measure should insist in ensuring that there are no further attempts to avoid the operation of the law in relation to the issue of Promissory notes."
> - …….

28. The collapse of the *Westpoint* group of companies was the precursor to the amendments in relation to promissory notes. The passage of the amending legislation was specifically designed to overcome an issue arising from the *Westpoint* collapse and the ensuing litigation.

29. The issue was considered by Finkelstein J[9]. By way of background, His Honour identified the relevant financial structure as follows;

> "The business of the Westpoint group was to construct large residential and retail developments. To finance a project most of the funds were borrowed from a traditional lending institution, such as a bank. Additional finance was raised from small investors. In the case of each development a structure along the following lines was established. A development company purchased the land and undertook the development. The development company borrowed funds from an institutional lender on the security of a first mortgage over the land and a charge over its assets and undertaking. What is referred to as a "mezzanine" company raised the balance of the funds from the public. Those funds were raised by way of promissory notes. The promissory notes had a minimum face value of $50,000 and a maturity date that was usually 36 months from the issue date. Investors were to receive interest on the amount of their investment, generally at the rate of 12% per annum payable monthly in arrears, together with an additional 2% of the capital invested payable on the maturity date. The fundraising was promoted by Information Memorandum issued by the mezzanine company."

30. Paragraphs 362-363 of the explanatory memorandum provided that;

> 362. One of the main issues arising from the Westpoint case is the inconsistent regulation of Promissory notes and debentures. Promissory notes are a form of debenture whereby borrowers raise funds from investors and promise repayment at a future point in time. However, within the Promissory note

[9] *York Street Mezzanine Pty Ltd (in liq)* [2007] FCA 922

regulatory regime, different regulation applies depending on the value of the note:

- if the Promissory note is valued at less than $50,000, it is regulated as a debenture;
- if it has a face value of at least $50,000, the note is regulated as a financial product.

363. This inconsistency produced the uncertainty in the Westpoint case. Westpoint tried to avoid the operation of the law relating to debentures by issuing Promissory notes with face values of at least $50,000. Because of the uncertainty regarding their regulatory treatment at that time, court action by ASIC was necessary to confirm that the Promissory notes on issue were subject to the operation of the Corporations Act (in this case, it was determined that the issue took the form of an interest in a managed investment scheme)."

31. Further, paragraphs 371- 373 provided that:

"Definition of debenture

371. Section 9 of the Corporations Act defines a 'debenture' and specifies exclusions. The amendment removes the exemption that a debenture does not include 'an undertaking to pay money under a promissory note that has a face value of at least $50,000'. [Schedule 3, item 1, section 9, paragraph (d), of definition of debenture]

372. With the removal of paragraph (d), all promissory notes, regardless of value, are treated as debentures. As such, promissory notes valued at $50,000 or over issued after commencement are subject to the same regulatory requirements as debentures including, inter alia, the issue of a trust deed, the appointment of a trustee and the issue of a prospectus.

373. The amendment removes the inconsistency between the regulation of promissory notes and debentures and avoids further uncertainty in the operation of the law.

32. As a consequence of the losses experienced by investors in Westpoint the CA was amended so as to remove the exclusion in relation to promissory notes from the definition of debentures. The relevant provisions of the explanatory memorandum that accompanied the amending bill clearly sets out the intentions of parliament by deleting the exclusion. It is plainly the intention that promissory notes now fall within the definition of debentures under the CA.

33. Another case arising from the collapse of the Westpoint Group was *Zhang v Minox Securities Pty Ltd*[10]. That proceeding concerned the conduct of Chen, who was an authorised representative of Minox. The issues revolved around his solicitation of persons to invest in promissory notes issued by the mezzanine companies. The possibility that insurance policies were written by QBE and held by Minox in respect of the relevant risks were in existence and as a consequence, the Plaintiff's sought to join QBE as a Defendant in the proceedings. In the course of considering whether or not the scope of the policies extended to the conduct of Chen, consideration was given as to whether or not the promissory notes issued or made by the mezzanine companies were "securities" within the scope of section 761A of the CA. As the terms of the CA at that time included the exclusion of a promissory note from the definition of debenture, it was held that the promissory notes were not securities.

34. Given the amendments that have since been made to the definition of debenture, the position that arose from the Westpoint litigation no longer applies. "Security" is defined in section 761A to mean;

    b. A debenture of a body.

35. If one returns to the definitions in section 9, a "*debenture of a body*" means a chose in action that includes an undertaking by the body to repay as a debt deposited with or lent to the body. That is to say, for the same reason that a promissory note now meets the definition of debenture, it likewise falls within the scope of security.

4.2 DISCLOSURE UNDER CHAPTER 6D OF THE CORPORATIONS ACT

Managed Investment Scheme

36. Chapter 6D of the CA provides for obligations of disclosure to investors about securities. For the avoidance of doubt, section 700 provides that the meaning of securities within this chapter is the same as contained in section 761A. The promissory notes to be issued by M101 are securities within the meaning of chapter 6D.

37. Section 708(8) provides that disclosure is not required in relation to offers to sophisticated investors. In summary, in order to fall within that exclusion;

[10] [2008] NSWSC 689

a. the investor must contribute an amount of at least $500,000; or

b. the investor must provide a certificate from an accountant within the last six months, which certifies that the investor has net assets and a gross income of at least the amounts stipulated by the regulations.

38. Section 708(10) provides an offer of a bodies securities does not need disclosure to investors if;

> "(10) An offer of a body's securities does not need disclosure to investors under this Part if
>
> (a) the offer is made through a financial services licensee; and
>
> (b) the licensee is satisfied on reasonable grounds that the person to whom the offer is made has previous experience in investing in securities that allows them to assess:
>
> (i) the merits of the offer; and
>
> (ii) the value of the securities; and
>
> (iii) the risks involved in accepting the offer; and
>
> (iv) their own information needs; and
>
> (v) the adequacy of the information given by the person making the offer; and
>
> (c) the licensee gives the person before, or at the time when, the offer is made a written statement of the licensee's reasons for being satisfied as to those matters; and
>
> (d) the person to whom the offer is made signs a written acknowledgment before, or at the time when, the offer is made that the licensee has not given the person a disclosure document under this Part in relation to the offer.

39. On the basis that M101 maintains its role as a corporate authorised representative of an AFSL licensee and deals exclusively with wholesale clients as instructed, disclosure is not required under Chapter 6D, if section 708(10) is otherwise complied with.

4.3 WHETHER THE ISSUE REQUIRES A TRUSTEE TO BE APPOINTED, AND A TRUST DEED TO BE PUT IN PLACE, UNDER CH2L

40. Section 283AA provides that;

"(1) Before a body:

(a) makes an offer of debentures in this jurisdiction that needs disclosure to investors under Chapter 6D, or does not need disclosure to investors under Chapter 6D because of subsection 708(14) (disclosure document exclusion for debenture roll overs) or section 708A (sale offers that do not need disclosure); or

(b) makes an offer of debentures in this jurisdiction or elsewhere as consideration for the acquisition of securities under an off-market takeover bid; or

(c) issues debentures in this jurisdiction or elsewhere under a compromise or arrangement under Part 5.1 approved at a meeting held as a result of an order under subsection 411(1) or (1A);

regardless of where any resulting issue, sale or transfer occurs, the body must enter into a trust deed that complies with section 283AB and appoint a trustee that complies with section 283AC.

41. By reason of the matters referred to in the previous section of this memorandum, disclosure is not required under Chapter 6D (assuming compliance with s 708(10) and consequently, a trustee and a trust deed will not be required.

4.4 WHETHER THE PROMISSORY NOTES ARE FINANCIAL PRODUCTS

42. Pursuant to section 764A(1)(a) a security, which in turn has been defined in section 761A to include a debenture, is a "*financial product*" for the purposes of this chapter. The proposed issue of promissory notes falls within this category.

43. Section 766A provides that a person provides a "*financial service*" if they deal in a financial product (section 766A(1)(a)). Thus, the issue of the Promissory Notes by M101 is the provision of a financial service.

44. Section 766B provides that;

"(1) For the purposes of this Chapter, ***financial product advice*** means a recommendation or a statement of opinion, or a report of either of those things, that:

(a) is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products, or an interest in a particular financial product or class of financial products; or

(b) could reasonably be regarded as being intended to have such an influence."

45. The combination of the above provisions confirms that;

a. The promissory notes are *financial products*;
b. The provision of advice that is intended to influence a person to buy such a promissory note is the provision of *financial product advice*;
c. The issuing of the promissory notes constitutes *dealing in a financial product*.
d. The issuing of the promissory notes is the provision of a *financial service*.

Self-dealing exemption

46. I am asked to advise as to whether the self-dealing exemption contained in section 766C(4)(c) applies. It has been suggested that, provided M101 simply lends the money to different parties, without investing in securities, then the investment business qualification shouldn't apply.

47. On the other hand, if M101 or an associated member of the IPO Wealth Group is to provide financial product advice by the recommendation and promotion of the promissory notes to investors, then an AFSL authorisation would be required.

48. Section 766C defines dealing in a financial product as;
    a. Applying for or acquiring a financial product;
    b. Issuing a financial product;
    c. In relation to securities and interests in managed investment schemes – underwriting the securities or interests;
    d. Varying a financing product;
    e. Disposing of a financial product.

49. Section 766C(4)(c) provides that certain defined conduct is deemed to *not* involve dealing in a financial product. Relevantly, a transaction entered into by a person who is a body corporate is taken not to be dealing in a financial product by that body corporate *if the transaction*

relates only to securities of that entity [11]. It is prima facie engaged in our client's situation as the promissory notes that are issued by M101 are securities of itself.[12] The prima facie position is however, subject to section 766C(5).

50. The exemption in relation to dealing in securities of that entity is excluded by section 766C(5) if the entity concerned;

    a. Carries on a business of investment in securities; and
    b. In the course of carrying on that business invests funds subscribed, whether directly or indirectly, after an offer or invitation to the public made on terms that the fund subscribed would be invested.

51. Sections 18 and 20 define "carrying on a business". It seems to me that there is no argument that M101 and its related entities[13] are carrying on a business of investment in securities, and I am proceeding on the basis of that assumption.

52. Section 766C(5)(b) then requires, for the exception to be operative, that the entity invests funds subscribed *after an offer or invitation to the public.* Section 82 provides*:*

> A reference in this Act to, or to the making of, an offer to the public or to, or to the issuing of, an invitation to the public is, unless the contrary intention appears, to be construed as including a reference to, or to the making of, an offer to any section of the public or to, or to the issuing of, an invitation to any section of the public, as the case may be, whether selected as clients of the person making the offer or issuing the invitation or in any other manner and notwithstanding that the offer is capable of acceptance only by each person to whom it is made or that an offer or application may be made pursuant to the invitation only by a person to whom the invitation is issued, but a bona fide offer or invitation is not taken to be an offer or invitation to the public if it:
>
> (a) is an offer or invitation to enter into an underwriting agreement; or
>
> (b) is made or issued to a person whose ordinary business is to buy or sell shares, debentures or interests in managed investment schemes, whether as principal or agent; or
>
> (c) is made or issued to existing members or debenture holders of a corporation and relates to shares in, or debentures of, that corporation; or

[11] section 766C(4)(c) and (d)
[12] See subparagraph (b) of the definition security in section 761A. It means a *debenture of a body*
[13] Section 20 includes carrying on a business alone or with others

(d) is made or issued to existing members of a company in connection with a proposal referred to in section 507 and relates to shares in that company.

53. In my view, the offer to wholesale clients to subscribe to the issue of promissory notes is an offer to *a section of the public…. whether selected as clients of M101 or in any other manner and notwithstanding that the offer is capable of acceptance only by each person to whom it is made or that an offer or application may be made pursuant to the invitation only by a person to whom the invitation is issued.* In addition, the offer to subscribe *is made on terms that the fund subscribed would be invested.*

54. Consequently, in my view the issue of the promissory notes it falls within the ambit of section 766C(5). The self-dealing exemption does not apply and M101 is therefore dealing in a financial product. There may be potential ways to escape the operation of 766C(5) e.g. is the offer to subscribe to the issue of the promissory notes *made on terms that the funds subscribed would be invested* [14]*.* For present purposes however, M101 should proceed on the basis that the self-dealing exemption does not apply.

4.5 WHETHER THE ISSUE OF THE PROMISSORY NOTES CONSTITUTES A MANAGED INVESTMENT SCHEME

55. A managed investment scheme is defined in section 9 of the CA which also articulates a number of exclusions that would otherwise meet the definition. Specifically, subparagraph (j) of the definition excludes the issue of debentures or convertible notes by a body corporate. Given the conclusions reached in relation to whether or not the issue of the promissory notes constitutes debentures within the meaning of the Act, in my view the same conclusion must apply in regard to consideration as to whether or not the scheme is a managed investment scheme within the meaning of the Act.

56. It follows that by reason of the classification of the promissory notes as debentures, that the issue of those notes does not constitute a managed investment scheme.

[14] See the last part of section 766C(5)(b)

4.6 IS A PRODUCT DISCLOSURE STATEMENT REQUIRED TO BE ISSUED IN RELATION TO THE PROMISSORY NOTES

57. Division II of part 7.9 of the CA provides for product disclosure statements. Section 1012A sets out the situations in which the provision of *financial product advice* that consists of or includes a recommendation to acquire a financial product gives rise to the obligation to provide a product disclosure statement for the product (section 1012A(1)).

58. Similarly, section 1012A sets out situations in which an offer relating to the issue of a financial product or the issue of a financial product gives rise to an obligation to give a product disclosure statement (section 1012B(1)).

59. In each of the foregoing provisions the requirement to provide a product disclosure statement only applies if the financial product advice is provided to the client as a retail client (section 1012A(3)(c)) or the financial product is to be issued to the person as a retail client (section 1012B(3)(b) and (4)(c)).

60. Sections 761G and 761GA set out of the definitions of what is a retail client as opposed to a wholesale client or a sophisticated investor. Those sections are complex and consequently I have set them out in their entirety. Section 761G provides as follows;

> "(1) For the purposes of this Chapter, a financial product or a financial service is provided to a person as a ***retail client*** unless subsection (5), (6), (6A) or (7), or section 761GA, provides otherwise.
>
> Note: The references in this section to providing a financial product to a person are not to be taken to imply that the provision of a financial product is not also the provision of a financial service (see the meaning of ***dealing*** in section 766C).
>
> Acquiring a financial product or financial service as a retail client
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> (2) For the purposes of this Chapter, a person to whom a financial product or financial service is provided as a retail client is taken to acquire the product or service as a retail client.
>
> Disposing of a financial product as a retail client
>
> (3) If a financial product is provided to a person as a retail client, any subsequent disposal of all or part of that product by the person is, for the purposes of this Chapter, a disposal by the person as a retail client.
>
> Wholesale clients

(4) For the purposes of this Chapter, a financial product or a financial service is provided to, or acquired by, a person as a ***wholesale client*** if it is not provided to, or acquired by, the person as a retail client.

General insurance products

(5) For the purposes of this Chapter, if a financial product is, or a financial service provided to a person relates to, a general insurance product, the product or service is provided to the person as a retail client if:

(a) either:

(i) the person is an individual; or

(ii) the insurance product is or would be for use in connection with a small business (see subsection (12)); and

(b) the general insurance product is:

(i) a motor vehicle insurance product (as defined in the regulations); or

(ii) a home building insurance product (as defined in the regulations); or

(iii) a home contents insurance product (as defined in the regulations); or

(iv) a sickness and accident insurance product (as defined in the regulations); or

(v) a consumer credit insurance product (as defined in the regulations); or

(vi) a travel insurance product (as defined in the regulations); or

(vii) a personal and domestic property insurance product (as defined in the regulations); or

(viii) a kind of general insurance product prescribed by regulations made for the purposes of this subparagraph.

In any other cases, the provision to a person of a financial product that is, or a financial service that relates to, a general insurance product does not constitute the provision of a financial product or financial service to the person as a retail client.

Superannuation products and RSA products

(6) For the purposes of this Chapter:

(a) if a financial product provided to a person is a superannuation product or an RSA product, the product is provided to the person as a retail client; and

(aa) however, if a trustee of a pooled superannuation trust (within the meaning of the *Superannuation Industry (Supervision) Act 1993*) provides a financial product that is an interest in the trust to a person covered by subparagraph (c)(i), the product is not provided to the person as a retail client; and

(b) if a financial service (other than the provision of a financial product) provided to a person who is not covered by subparagraph (c)(i) or (ii) relates to a superannuation product or an RSA product, the service is provided to the person as a retail client; and

(c) if a financial service (other than the provision of a financial product) provided to a person who is:

(i) the trustee of a superannuation fund, an approved deposit fund, a pooled superannuation trust or a public sector superannuation scheme (within the meaning of the *Superannuation Industry (Supervision) Act 1993*) that has net assets of at least $10 million; or

(ii) an RSA provider (within the meaning of the *Retirement Savings Accounts Act 1997*);

relates to a superannuation product or an RSA product, that does not constitute the provision of a financial service to the person as a retail client.

Traditional trustee company services

(6A) For the purpose of this Chapter, if a financial service provided to a person is a traditional trustee company service, the service is provided to the person as a retail client unless regulations made for the purpose of this subsection provide otherwise.

Other kinds of financial product

(7) For the purposes of this Chapter, if a financial product is not, or a financial service (other than a traditional trustee company service) provided to a person does not relate to, a general insurance product, a superannuation product or an RSA product, the product or service is provided to the person as a retail client unless one or more of the following paragraphs apply:

(a) the price for the provision of the financial product, or the value of the financial product to which the financial service relates, equals or exceeds the amount specified in regulations made for the purposes of this paragraph as being applicable in the circumstances (but see also subsection (10)); or

(b) the financial product, or the financial service, is provided for use in connection with a business that is not a small business (see subsection (12));

(c) the financial product, or the financial service, is not provided for use in connection with a business, and the person who acquires the product or service gives the provider of the product or service, before the provision of the product or service, a copy of a certificate given within the preceding 6 months by a qualified accountant (as defined in section 9) that states that the person:

(i) has net assets of at least the amount specified in regulations made for the purposes of this subparagraph; or

(ii) has a gross income for each of the last 2 financial years of at least the amount specified in regulations made for the purposes of this subparagraph a year;

(d) the person is a professional investor.

Offence proceedings--defendant bears evidential burden in relation to matters referred to in paragraphs (7)(a) to (d)

(8) In a prosecution for an offence based on a provision of this Chapter or Part 6D.3A, a defendant bears an evidential burden in relation to the matters in paragraphs (7)(a) to (d) as if those matters were exceptions for the purposes of subsection 13.3(3) of the *Criminal Code* .

Other proceedings relating to subsection (7) products--presumption in non-criminal proceedings of retail client unless contrary established

(9) If:

(a) it is alleged in a proceeding under this Chapter (not being a prosecution for an offence), or in any other proceeding (not being a prosecution for an offence) in respect of a matter arising under this Chapter, that a particular financial product or financial service was provided to a person as a retail client; and

(b) the product or the service is one to which subsection (7) applies;

it is presumed that the product or service was provided to the person as a retail client unless the contrary is established.

Note 1: There is no such presumption in relation to the provision of a product or service that is or relates to a general insurance product, a superannuation product or an RSA product. Whether or not such a product, or a service relating to such a product, was provided to a person as a retail client is to be resolved as provided in subsection (5) or (6), as the case requires.

Note 2: In criminal proceedings, a defendant bears an evidential burden in relation to the matters in paragraphs (7)(a) to (d) (see subsection (8)).

<u>Regulations and paragraph (7)(a)</u>

(10) In addition to specifying an amount or amounts for the purposes of paragraph (7)(a), the regulations may do either or both of the following:

(a) deal with how a price or value referred to in that paragraph is to be calculated, either generally or in relation to a specified class of financial products;

(b) modify the way in which that paragraph applies in particular circumstances.

Regulations and paragraph (7)(c)

(10A) In addition to specifying amounts for the purposes of subparagraphs (7)(c)(i) and (ii), the regulations may do either or both of the following:

(a) deal with how net assets referred to in subparagraph (7)(c)(i) are to be determined and valued, either generally or in specified circumstances;

(b) deal with how gross income referred to in subparagraph (7)(c)(ii) is to be calculated, either generally or in specified circumstances.

What happens if a package of general insurance products and other kinds of financial products is provided?

(11) If:

(a) either:

(i) in a single transaction, 2 or more financial products are provided to a person; or

(ii) a single financial service provided to a person relates to 2 or more financial products; and

(b) one or more, but not all, of the financial products are general insurance products;

subsection (5) applies to the transaction or service so far as it relates to the general insurance products, and subsection (6) or (7), as the case requires, applies to the transaction or service so far as it relates to other financial products.

Definition

(12) In this section:

"small business" means a business employing less than:

(a) if the business is or includes the manufacture of goods--100 people; or

(b) otherwise--20 people.

61. Section 761GA provides

> For the purposes of this Chapter, a financial product, or a financial service (other than a traditional trustee company service or a crowd-funding service) in relation to a financial product, is not provided by one person to another person as a ***retail client*** if:
>
> (a) the first person (the ***licensee***) is a financial services licensee; and
>
> (b) the financial product is not a general insurance product, a superannuation product or an RSA product; and
>
> (c) the financial product or service is not provided for use in connection with a business; and
>
> (d) the licensee is satisfied on reasonable grounds that the other person (the ***client***) has previous experience in using financial services and investing in financial products that allows the client to assess:
>
> (i) the merits of the product or service; and
>
> (ii) the value of the product or service; and
>
> (iii) the risks associated with holding the product; and
>
> (iv) the client's own information needs; and
>
> (v) the adequacy of the information given by the licensee and the product issuer; and
>
> (e) the licensee gives the client before, or at the time when, the product or advice is provided a written statement of the licensee's reasons for being satisfied as to those matters; and
>
> (f) the client signs a written acknowledgment before, or at the time when, the product or service is provided that:
>
> (i) the licensee has not given the client a Product Disclosure Statement; and
>
> (ii) the licensee has not given the client any other document that would be required to be given to the client under this Chapter if the product or service were provided to the client as a retail client; and
>
> (iii) the licensee does not have any other obligation to the client under this Chapter that the licensee would have if the product or service were provided to the client as a retail client."

62. If the issue of the Promissory Notes by M101 is contained to wholesale clients as instructed, then a product disclosure statement is not required. M101 will need to be vigilant in ensuring it remains compliant in dealing with wholesale clients only. I reiterate that strict observance must be paid to section 708(10)

4.7 WHETHER AN AFSL IS REQUIRED TO ISSUE THE PROMISSORY NOTES, DEAL WITH THEM AND PROMOTE THEM

63. As previously discussed in paragraphs 46-54 the self-dealing exemption contained in section 766C(4)(c) does not apply. Consideration should be given to ensuring that the provisions of the corporate authorised representative agreement expressly extend to the issue of the promissory notes.

64. The proposed appointment as a corporate authorised representative provides for an authorisation on the part of M101 to provide financial product advice in respect of the following classes of financial products;

    a. Deposit and payment products limited to basic deposit products and deposit products other than basic deposit products;
    b. Derivatives;
    c. Foreign exchange contracts;
    d. Interests in managed investments schemes excluding investor directed portfolio services;
    e. Interest in managed investment schemes limited to MDA services;
    f. Securities.

    Applying for, acquiring varying or disposing of a financial product on behalf of another person in respect of the following classes of financial products (note this also includes “arranging” for a person to deal in the following classes of financial products)

    g. Deposit and payment products limited to basic deposit products and deposit products other than basic deposit products;
    h. Derivatives;
    i. Foreign exchange contracts;
    j. Interests in managed investment schemes excluding investor directed portfolio services;
    k. Securities;

l. Underwriting an issue of securities

With respect to wholesale clients only.

65. In my view, where the proposed appointment as a corporate authorised representative permits the provision of financial product advice and selling a financial product that relates to *securities,* the authorisation means and includes a reference to *securities* as that term is defined in the *Corporations Act*. That arises by reason of the construction of the terms of the appointment in the context of the market in which the parties are operating and the objective circumstances known to both parties at the time of entering into the agreement[15].

66. Notwithstanding the foregoing, if M101 or MWP provides *financial product advice* as defined in section 766B then an AFSL is required in any event.

67. In circumstances where it is intended on the part of M101 to make recommendations to investors so as to encourage them to subscribe for the promissory notes, the giving of financial advice requires an authorisation. In circumstances where there is no intention to deal with retail clients but rather, to focus solely on wholesale clients or sophisticated investors then the authorised representative appointment provides adequate coverage, although it does not extend to dealing with sophisticated investors.

68. In order to remove any doubt about coverage pertaining to promissory notes, subsection (k) of the authorisation could be amended to read *securities as defined in the Corporations Act.*

4.8 WHETHER ASIC'S REGULATORY GUIDES IN RELATION TO THE MARKETING AND PROMOTION OF PROMISSORY NOTES NEED TO BE COMPLIED WITH

69. Regulatory guides published by ASIC have no legal status insofar as compliance with the CA is concerned. Like many other regulators[16] these guidelines represent the regulator's view of the applicable law. They are not however, a substitute for the applicable law.

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[15] *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* [2015] HCA 37; *Royal Botanical Gardens and Domain Trust v South Sydney City Council* [2002] HCA 5

[16] Eg Australian Taxation Office, Civil Aviation Safety Authority

70. The guidelines demonstrate ASIC's approach to the relevant issues. As described on the ASIC website[17]

    Regulatory guides give guidance to regulated entities by:

    - explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
    - explaining how ASIC interprets the law
    - describing the principles underlying ASIC's approach
    - giving practical guidance (for example, describing the steps of a process such as applying for a license or giving practical examples of how regulated entities may decide to meet their obligations).

71. If a compliance issue was being considered, and the entity had followed the guidelines of ASIC, then even if the guidelines were demonstrated to be erroneous, the prospect of prosecution would be minimal. Therein lies the benefit/significance of the guidelines. If one were to adhere to ASIC's view of the world, the prospect of prosecution or penalty for a breach becomes unlikely. In other words, even if ASIC is ultimately shown to be wrong, if you adhere to the advice of the regulator you can expect not to be penalised.

72. Similarly, if we conclude that the regulator is wrong in its guidelines, we might well expect attention from ASIC and possible sanctions, If however, by court action our interpretation is shown to be correct then ASIC fails in its proceedings.

Conclusion

73. There have been many issues raised by my instructing solicitor and I trust that they have each been addressed. In the main I am in agreement with the views of my instructor but if any matters require clarification please do not hesitate to contact me.

Dated 30 July 2019

J RIBBANDS
Owen Dixon Chambers West

[17] https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/