

**FEEDBACK ON THE PROPOSED MODIFICATIONS TO CLASS ORDERS 02/319, 02/172 AND
02/178**

B1Q1. Do you agree with this proposal?

Answer:

- (a) I agree with ASIC's proposal:
- (i) to renew the Class Order;
 - (ii) to increase the investment limit, but would have preferred the increase to be from \$250,000 to \$2million, or at least \$750,000, instead of \$500,000.
- (b) I disagree with the proposal to increase the maximum number of members of a horse racing syndicate from 20 to 50.

B1Q2. Are there any practical problems associated with our proposal?

Yes, there are significant practical problems associated with ASIC's proposal, mainly associated with the increase in the number of participants.

Increasing the investment limit

This can deliver significant benefits if both ASIC and the PRA'S improve their performance.

Increasing the number of participants

There are both legal and practical problems associated with this proposal.

- The ownership agreements typically being approved by the Lead regulators are not appropriate for such large scale ownership groupings.
- The Class Order is lacking terms requiring that ownership agreements include provisions which are essential for managing schemes with large scale ownership groupings.
- Most of the current promoters and syndicators do not possess the administrative and accounting infrastructure to effectively manage such large ownership groupings.
- Most race clubs cannot physically accommodate such large ownership groupings with full race day owners' privileges (racecourse entry, members reserve and mounting year passes, winners and losses bars, especially on major race days). Simply put, on the major race days when owners' privileges are restricted, who will receive the privileges and who will miss out? Owners' privileges are a key motivator for retail investors when buying whole shares, and they will opt for the lowest cost entry point that they think will entitles them to full privileges. When most owners end up not receiving full privileges, it will lead to significant investor dissatisfaction.
- Large scale co-ownership groupings represent a significant risk to external service providers being able to obtain payment for services. An average race horse will cost between \$40,000 and \$60,000 per annum to maintain, train and race. Each co-owner is usually only liable under the co-ownership arrangement to contribute one's

proportion of the costs of maintaining and racing the horse, yet if a co-owner defaults in relation to any payment obligation, this has the potential to negatively impact both external service providers and the other co-owners, because it has the potential to render the whole arrangement insolvent. Very few co-ownership agreements appropriately address this potential situation.

- Also, an increasing number of co-ownership arrangements are now being established by promoters, particularly horse trainers, comprised of owners who are not known to each other and are unlikely to want to acquire the share(s) of a defaulting owner unless the horse is performing particularly well at the time the default occurs, which is often not the case.

B1Q3. What benefits do you consider will result from the proposal?

Raising the investment limit

This proposal will be beneficial, but only if the PRA'S improve their performance administering the Class Order relief. Raising the investment limit will enable promoters who are currently promoting shares in non-compliant offers above the current investment limit to become compliant.

Increasing the number of participants

This proposal will deliver more problems than benefits.

A better alternative approach would be to require the promoter of large scale 50 share syndicates to incorporate a company and issue 50 shares. This would significantly reduce the risk to external service providers when providing services in relation to the horse, or the entity. The entity could then register a syndicate, listing the 50 shareholders as members and by so doing, ensure that their names appear in the race book. This would but would not eliminate the concerns expressed on answer to B1Q2.

B1Q4. Are there any additional costs associated with the implementation of this proposal?

Increasing the investment limit

No.

Increasing the number of participants

Yes. Presumably, the more shares a promoter has to sell to fully syndicate each horse, the higher the marketing costs; and the larger the resultant ownership groupings, the higher the administration costs.

B1Q5. Are there situations that would not fall within our proposed changes that should be covered?

The thoroughbred stallion business is now much more public and much less private than it was when the Class Order relief was first introduced.

In 2002, very few stallions covered books of mares of more than 100 mares, now a significant number of stallions cover books of mares of more than 100 mares, and some more than 150 mares. This has the potential to generate significant scheme income for shareholders in addition to the value of the service rights attaching to their own shares.

The market has changed, as had the motivation for investors to invest in ownership interests (shares).

Attached to this paper is a copy of the current Stallions Tables (published today) of the leading stallions in Australia. The ones highlighted in yellow are syndicated stallions that are governed by documentation compiled by this firm. Most of the other stallions that appear in the tables are owned by international studmasters Coolmore, Darley, etc, and shuttle to Australia for the southern hemisphere stud season.

B1Q6. Is any transition period required?

No.

B2Q1. Do you agree that the relief provided in [CO 02/172] and [CO 02/178] should be continued?

Yes.

B2Q2. Do you agree with the proposal in respect of [CO 02/172]?

B2Q3. Do you agree with the proposal in respect of [CO 02/178]?

Limit on number of issued interests

No.

B2Q4. Does the limit of 40 shares issued or sold in any 12 month period remain appropriate in light of current industry practice for small-scale schemes?

No.

Any logical assessment of whether a scheme is a small-scale or large-scale scheme should take account the number of members and issued ownership interests, and the cumulative capital value of those interests, in exactly the same way as the 20/12 rule relating to personal offers.

A limit of \$2million cumulative capital value should be introduced.

ASIC should modify its current proposal along the lines of the following:

A scheme that satisfies either of the following terms will be eligible for relief from the requirement to be registered as a managed investment scheme, and the promoter relieved from the requirement to hold an AFS Licence:

(a) Small-scale scheme by number of participants

a scheme that has no more than 20 members owning no more than 20 proportionate ownership interests, provided the promoter/studmaster holds and maintains at least a 10% ownership interest in the stallion, with no limit on the cumulative value of all scheme interests.

(b) Small-scale scheme by cumulative capital value of all scheme interests

a scheme that has a total cumulative value of all scheme interests of not more than \$2 million, provided the promoter/studmaster holds and maintains a least a 10% ownership interest in the Stallion, with no limit on either the number of members or scheme interests.

Option (a) will continue to accommodate the type of high value co-ownership arrangements being established by some of the leading international commercial studmasters with participation by a relatively small number of high net worth individuals who are either existing clients or otherwise experienced breeders. Arguably these high net worth investors are able to assess for themselves the investment risk and do not require the added protection afforded by the provisions of the Act relating to registered schemes.

Option (b) would better accommodate the type of ownership arrangements that a significant number of competent local studmasters, but with limited capital, would like to establish with their existing clients if the relief was available. Arguably these lower capital value schemes do not warrant incurring the additional costs associated with establishing and operating such schemes as registered schemes.

The above proposal maintains consistency with the provisions of the Act relating to personal offer schemes and avoids ASIC otherwise having to determine arbitrary limits on both the number of participants and the number of proportionate scheme interests that have little, if any practical relevance to current industry practices.

All other arrangements can be adequately dealt with as:

- (a) registered schemes;
- (b) wholesale schemes; or
- (c) personal offer schemes.

B2Q5. Should there be a change to the content requirements for a stallion scheme agreement under [CO 02/178]?

Yes.

Attached to this paper is a copy of our revised template Owners Deed of Agreement for Class Order compliant Stallion Syndicates. It contains provisions that are consistent with many of the provisions set out in the Corporations Act relating to managed investment schemes, and there is no reason that scheme agreements should not follow such a template, regardless of whether or not the scheme is a registered, wholesale, or Class Order compliant template.

The modified Class Order would appear to still focus more on disclosure, and less on prescribing meaningful content for scheme agreements. The Class order should do both.

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