CHARTERED ACCOUNTANTS™
AUSTRALIA + NEW ZEALAND

4 July 2018

Business Law team
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140
New Zealand

via email: corporate.law@mbie.govt.nz

Dear Sir or Madam

Submission on discussion document: A new regime for unravelling Ponzi schemes

Chartered Accountants Australia and New Zealand welcomes the opportunity to provide a submission to the Ministry of Business, Innovation & Employment on its discussion document: A new regime for unravelling Ponzi schemes. Appendix A provides our responses to the consultation document questions. Appendix B provides more information about Chartered Accountants Australia and New Zealand.

Should you have any queries concerning the matters raised in the following questionnaire or wish to discuss them in further detail, please contact me via email at karen.mcwilliams@charteredaccountantsanz.com or phone (612) 8078 5451.

Yours sincerely,

[no signature on word version]

Karen McWilliams
Business Reform Leader
Chartered Accountants Australia and New Zealand

Appendix A - Submission on discussion document: *A new regime for unravelling Ponzi schemes*

Your name and organisation

Name	Karen McWilliams
Organisation	Chartered Accountants Australia & New Zealand

Please select if your submission contains confidential information:

☐I would like my submission (or specified parts of my submission) to be kept confidential, and attach my reasons for this for consideration by MBIE.

Responses to discussion document questions

1	Are there currently any other methods for resolving a Ponzi scheme which officials should keep in mind? If so, what are they?
	Other methods which could be considered include Voluntary Administration, Just and Equitable Liquidation under s241(2)(d) of the Companies Act and Receivership by FMA under FMCA.
2	Do you agree with Glazebrook J's statement that "an accident of timing as to when funds are withdrawn should not favour one defrauded investor over another"?
	Although we can see this could bring inequities, we support this approach.
3	Do governing documents ordinarily cover the scenario where an investor is overpaid? If so how is this provided for?
	No comments from our members.
4	Do you consider that, where investors are all the subjects of fundamentally the same fraud, the strict legal form of a Ponzi scheme should not impact the outcomes of investors?
	We support this approach.
5	Do you agree with the objectives we have identified for the regime for unwinding Ponzi schemes?
	Yes.
6	Do you agree with problems identified with the status quo? Are there any additional issues which we should seek to address?
	No additional comment. No other issues identified.

7	Do you agree with the preferred option we have chosen?
	On balance we support the option chosen, however we note that some members remain unconvinced of the need for a bespoke regime
8	Do you agree with our design goals? Are there any other goals which the system should be designed to achieve?
	No other matters identified.
9	Are there any other factors which you think should be treated as indicating that an investment scheme is a Ponzi scheme?
	We believe the failure to invest in the promised investments is an important factor.
10	What are your views on our proposed definition of a Ponzi scheme: • Do you consider that our definition of a Ponzi scheme might capture any investment structures or products which it should not? • Do you consider that the definition of a Ponzi scheme should seek to capture any other investment structures or products?
	We share the concern that any strict definition or list will be used to create new structures designed to specifically fall outside the definition. Therefore it is important to ensure there is flexibility for other circumstances and factors to be taken into account while still having clarity over what would fall within the legislation. We support limiting the definition to the schemes listed in paragraph 120 because these are covered by existing protections.
11	Do you consider that the third limb of the proposed definition of a Ponzi scheme should be expanded to capture investments more generally?
	No.
12	Are you aware of any cases in which our proposed definition would have failed to capture a Ponzi scheme?
	No comments from our members.
13	Do you agree with the criteria for identifying when an investment scheme should be able to be declared a Ponzi scheme?
	We support each of these as criteria in their own right. That is one or other of these characteristics can identify a scheme as a Ponzi scheme and not all need to be present.
14	Do you consider that there are any additional or alternative criteria which should need to be met in order for a scheme to be declared to be a Ponzi scheme?

	We consider these elements encompass the identified situations and criteria.
15	Do you consider that proving fraudulent intent on the part of the operator of an investment scheme should be a necessary requirement to establish that that scheme is a Ponzi scheme?
	No.
16	Do you consider that the test for whether an investment scheme is a Ponzi scheme should be: • based on a set of fixed criteria? • At the absolute discretion of the courts? • a combination of limited discretion by the courts based on a set of criteria?
	We support a combination as there will always be circumstances designed to circumvent fixed criteria. Allowing limited discretion by the courts will enable these to be appropriately covered.
17	Is it appropriate for the liquidator of a Ponzi scheme to have the same duties and powers of the liquidator of a company under the Companies Act?
	Yes.
18	Do you agree that a liquidator should be able to exercise all powers, rights, and privileges that the operator of the Ponzi scheme had prior to that liquidation – notwithstanding that any arrangements contemplate that those powers, rights, and privileges would end on the appointment of a liquidator?
	We support this approach.
19	Do you think that liquidation is an appropriate model for resolving a Ponzi scheme? If you think a different model is more appropriate please explain why you consider this to be the case.
	We believe it is an appropriate model.
20	Do you agree that the process for appointing a liquidator is an appropriate model on which to base the process for declaring an investment scheme is a Ponzi scheme?
	Yes but see our response to question 22 below.
21	Do you agree that that in order to declare an investment scheme to be a Ponzi scheme the High Court must be satisfied on the balance of probabilities that it is in fact a Ponzi scheme?
	This seems a reasonable basis in these circumstances.
22	What are your views on the list of parties that would be able to seek a declaration that an investment scheme is a Ponzi scheme?
	We do not support the list of parties under this process. They each have different roles,

	responsibilities and legal requirements which requires a different approach for each. The main parties able to seek a declaration should be the FMA and SFO. These are crown entities who have the authority and rights to investigate complaints prior to apply to the High Court. This enables any application to have due process in advance and will limit the danger of irresponsible claims. If the High Court does not agree with the application, the costs will be paid for by the agency applicant. A liquidator or receiver also have a legal responsibility to investigate claims relevant to the recovery of assets and funds and so have a legitimate role in seeking an declaration from the High Court. Similar to the crown entities, they have due process prior to seeking a declaration. If the High Court does not agree with the application, the costs will be paid for out of the liquidation or receivership. A manager, supervisor, administration manager, custodian or discretionary investment management service licensee have responsibility for managing schemes, operations or assets. They should have a responsibility to report suspected behaviour to the crown entities but not to seek a declaration in their own right. This will ensure appropriate processes around activity and claims. An auditor and an actuary have specific, limited roles set out in legislation and are not involved in day to day management. They should have a responsibility to report suspected behaviour to the crown entities but not to seek a declaration in their own right. Both roles are required to be undertaken by regulated professionals who are already subject to Codes of Conduct which cover suspected non-compliance and so the level of additional legislative requirements should be considered in light of existing obligations. An investor or other person should report any suspected behaviour to the crown entities to enable due process prior to a High Court claim. They should not be able to seek a declaration directly. This will negate the risk of nefarious claims and claims where costs cannot be recovered from the person who unsuccessfully seeks a declaration. This approach will not be a barrier to investors reporting such concerns as they may be made to the crown entities at any time through a defined process and at no or limited cost. The financial risk of seeking a declaration which is not upheld rests with the crown entity.
23	Do you agree that where the courts consider that a scheme may be a Ponzi scheme, but lack sufficient evidence to make an order to that effect, that the court be able to appoint an insolvency professional to examine the affairs of the scheme?
	We agree with this approach and note the costs of this examination should be covered in line with our response to question 22. We note that in practice this could be a difficult engagement to fulfil and recommend that a timescale be placed on the examination, such that a report should be made to the Court on results of the examination within four weeks. During this time, it is also recommended that a moratorium be placed on the investment fund.
24	What level of certainty that a scheme may be a Ponzi scheme should be required to make such an appointment?
	Due to the nature of a Ponzi scheme it will not be possible to have certainty and data is unlikely to be available for assessment other than factual commentary against criteria and

	opinion.
25	How long would it take, and what do you think the cost would be, for an insolvency professional to examine the affairs of a scheme and advise the court whether, in their professional opinion, there is sufficient evidence to conclude that that scheme is in fact a Ponzi scheme?
	Access or availability of books and records will be difficult. It is unlikely that there will be sufficient evidence to form an opinion. It is noted that the lack of evidence over investments or operations may be a main deciding factor in the suspicion that the scheme is a Ponzi scheme. The number of investors may also impact on the ability of an insolvency profession to obtain sufficient information to form an opinion. If a default period is required, we suggest four weeks (with ability to extend) is appropriate. This may provide sufficient time to form an opinion but is unlikely to enable sufficient evidence to support the opinion for the reasons explained here.
26	Where an investor seeks a declaration that an investment scheme is a Ponzi scheme should the Crown be required to fund the appointment of the relevant insolvency professional if it is found that the scheme is not a Ponzi scheme? If not who should bear that cost and why?
	We do not support investors being able to seek a declaration. We believe it is more appropriate for the declaration to be requested by a crown body and this will enable costs and accountability to be managed. We set out in question 22 our recommendation for process and costs.
27	Should there be a set period for which an insolvency professional should be able to be appointed?
	We recommend a period of four weeks with ability for the insolvency professional to seek an extension from the court if there are valid reasons to suspect that further relevant information will be available after that period.
28	Do you consider that investment schemes which are invested in only by investment businesses, large persons and government agencies should not be able to be declared to be Ponzi schemes?
	We do not see the need for differentiation for these purposes.
29	Do you consider that it may be in investors' interests for investment schemes, which have invested substantially in a Ponzi scheme, to be able to be wound up as if they were a Ponzi scheme themselves?
	Our members' views on this matter.
30	Do you think that measures are needed to minimise or mitigate the consequences for an investment scheme or its operator of a failed attempt to have it declared to be a Ponzi scheme?
	We support measures to minimise these risks. Changing the process for seeking a declaration

	so that only crown entities or liquidators or receivers are able to seek the declaration, as noted in our response to question 22 above, will limit any such potential damage as it introduces additional rigour to the initial process. We note that the parties identified in paragraph 145 do not all have the same duties and responsibilities.
31	Should there be a limit placed on the ability of investors to bring proceedings to have a scheme declared to be a Ponzi Scheme?
	Yes. See our response to question 22 above
32	Should a defence be available to investors who in good faith bring a proceeding that a scheme is a Ponzi scheme from claims for damages brought by the operator of the investment scheme?
	No. See our response to question 22 above. An investor approaching the FMA or SFO with a genuine suspicion would be protected through these channels.
33	Do you consider that there should be a presumption that a Ponzi scheme was a Ponzi scheme for all time (so there is no need to identify when the scheme became a Ponzi scheme unless there is evidence to the contrary)?
	We note the difficulties in ascertaining the details of a Ponzi scheme due to lack of records and fraudulent entries. Therefore while we would not ordinarily support such a presumption in these cases we believe it is expedient to do so. The alternative would be to use scarce funds and resources in attempting to set a date. Under the proposals, the period for clawback of distributions is restricted to four years and recovery requires a court notice and is subject to defence (paragraphs 192 to 199). We believe this is adequate protection for individual investors caught up in a Ponzi scheme and the presumption that the scheme was always a Ponzi scheme would not have an adverse effect on recovery of individual investors' funds. The other aspect related to timing is that a presumption of a Ponzi scheme from the start will mean that all investors will be entitled to distributions if they are still in the scheme on liquidation. While initial investors may have joined a genuine scheme, if they remained in the scheme until liquidation, they will have been part of the Ponzi scheme. As the records would be unclear as to when there was a change, it is not unreasonable for these investors to be treated equally with later investors. If there is a clear point of change to a Ponzi scheme, the presumption would not arise and these investors would be excluded from distribution calculations before that point. Therefore we support a presumption in the absence of clear and readily available evidence of a specific start date.
34	Do you think that there should be a statutory default (say 5 years) for how far back a scheme is a Ponzi scheme in cases where a liquidator is not able to identify a point (or period) at which the scheme became a Ponzi scheme?
	See response to question 33.

35	Do you agree that, in the case of Ponzi schemes, tracing is an inappropriate remedy to resolve investors' claims?
	We note that this approach is counter to established law of general property rights. However in these instances we believe it is the right approach to not allow tracing of assets.
36	If you favour keeping tracing as a potential remedy in the case of Ponzi schemes how would you address the issues identified with its application?
	N/A
37	Do you agree that investors should not be able to retain any fictitious profits paid to them?
	Within the framework proposed in the legislation, including a set clawback period, we support this approach.
38	Do you agree that there should be a limit on the period of a clawback?
	Yes.
39	Do you agree that four years is a reasonable period for a clawback to operate? If not what alternative would you propose?
	We have not been able to establish a precedent for four years as the clawback period. However we support creating certainty in this instance and support four years as a reasonable period.
40	Do you think that the liquidator of a Ponzi scheme should be able to apply to the courts to extend the period of vulnerability, in respect of specific investors, where it can be shown that the investor received distributions in bad faith?
	Yes, although we note that 'bad faith' will require a definition and appropriate standards relating to actual or expected knowledge.
41	Do you agree that in order to have the benefit of a defence against the clawback powers of the liquidator investors should be required to demonstrate that *a reasonable person in their position would not have suspected, and they did not have reasonable grounds for suspecting, that a Ponzi scheme existed*? If not, what alternative test would you propose?
	We do not support defence against clawback in the four years. This appears to run counter to the premise of treating all investors equally. However we do support a special claim of significant financial hardship (question 42) as long as the investor acted in good faith and with reasonable grounds. We support the option of a defence for any specific investors facing an extension of the period of vulnerability.
42	Do you agree that significant financial hardship is an appropriate criterion for determining whether an investor merits retaining funds received from a Ponzi scheme?

	Yes.
43	Do you consider that alternative criteria should be used for determining whether an investor merits retaining funds received from a Ponzi scheme?
	Our members have no alternative suggestions.
44	Do you consider that a whistle blower safe harbour should be provided to investors in a Ponzi scheme? If there is to be a safe harbour, do you consider that this should be available to all investors or just the first investor to 'blow the whistle'?
	We do not see the need to introduce additional requirements.
45	Do you think that a defence should be provided for investors who substantially alter their position in the reasonably held belief that a distribution or withdrawal was valid and would not be set aside?
	No.
46	Do you agree that recovery against trade creditors of a Ponzi scheme should continue to be dealt with under the ordinary principles of insolvency law?
	Yes.
47	Do you agree that a proportional distribution of assets is preferable in the case of all Ponzi schemes regardless of the legal structure of the Ponzi scheme?
	Yes. We agree with the statement that a Ponzi scheme is a fraud and so segregation is fictional.
48	Do you have any information about the cost to find out whether the losses specifically attributable to individual investors are able to be identified?
	N/A
49	Do you agree that investors in a Ponzi scheme should not be entitled to the benefit of any fictitious profits allocated to them when deciding their proportional entitlements to the assets of a Ponzi scheme?
	We support this approach. However, we note that in practice, this could be a complicated process.
50	What is the most appropriate model for distributing assets?
	Our preference is for the net investment model. This appears to us the most sensible and practical option assuming withdrawals are valid distributions. We consider there may be potential injustices with the timing of the Rising tide and Alternative models. However we note that the main criteria for any option is to have a clear, consistent and easily understood model which enables everyone to understand their potential liability and likely

	outcome and transparency over process.
51	Are there any additional models which we should consider?
	No additional comments.
52	Should investors' losses be able to be adjusted to take account of inflation or any other factors?
	Our preference would be for a simple model. However in years of higher inflation, accounting for inflation could make quite a difference to the eventual outcome for investors and so we support including inflation as long as the process for calculating this is able to be cost effective. This means the process must be transparent, consistent and easy to understand.
53	Are there any additional or alternative criteria which we should use to assess the various models for distributing assets to investors?
	Fairness is important but as the schemes differ different investors, the perception of fairness will be not be the same across investors. This will need to be explained if maintained as a criteria. Certainty over how the distributions are calculated, and consistent application, would be the overriding factors.

Other comments

We applaud the intention behind the proposal to set separate legislation of unravelling Ponzi schemes but do have concerns over the practical implementation. These concerns stem primarily from the difficulty of defining and ascertaining either the existence, or the commencement, of a Ponzi scheme given the fraudulent nature of the activity and lack of definitive records or data.

Within this backdrop, we agree that in theory the proposals appear reasonable and logical (subject to specific comments raised above). We note that the proposals relate solely to the distribution of recoveries and do not cover actions against the perpetrators. We assume that this is in the belief that existing legislation covers these other aspects appropriately. We recommend that the process for obtaining a freezing order from the FMA over assets of the perpetrators needs consideration. Quick and efficient action is essential to secure assets in cases of criminal behaviour and fraud.

Appendix B

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 120,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation professional accountants across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.