

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

1 June – 3 June 2010

Question: BET 31

Topic: Colonial First State Mortgage - Frozen Funds

Hansard Page: E126-127 (01/06/2010)

Senator WILLIAMS asked:

Senator WILLIAMS—Thank you, ASIC representatives, for your time tonight. I want to follow on from Senator Eggleston as far as the freezing of the funds. Was it not the case that these funds were in fear of having a run on them or actually did have a run on them during the global financial crisis? That would have been the main reason they were frozen.

Mr D'Aloisio—It is an issue of if, for example, they depended on new money coming in and new money did not come in, then clearly you would get a run if there were a lot of withdrawals. So there could be a number of reasons. But, yes, in broad terms what you say is probably right.

Senator WILLIAMS—I think that would have been the case. Senator Sherry was well aware at the time, because I spoke to him personally, when the government underwrote those investments in the ADIs but not in these companies that are not registered ADIs. Of course, as I have said before, if you underwrite investments in that lot of companies and not that lot, they do not have the government guarantee, and people are going to withdraw their money out of that and put it into a safer haven. That was a serious problem with the way the government underwrote these various funds, banks and ADIs et cetera. Those other companies were not covered under ASIC. The Colonial First State mortgage income fund was terminated on 1 March. Are you aware of that?

Mr D'Aloisio—It does ring a bell, yes.

Senator WILLIAMS—They were making payments over a period of time, but they would not pay any interest, apparently. Is Colonial First State mortgage owned by the Commonwealth Bank? We found out through the Storm issue that Colonial Margin Lending is. As soon as I see the word 'Colonial', I think, 'Perhaps that is owned by the Commonwealth Bank.' Do you know if it is?

Mr D'Aloisio—I think it is, yes.

Senator WILLIAMS—They are a big organisation. If one of their subsidiary companies were frozen, you would wonder why they could not pay their money back with interest. But it has obviously caused a lot of heartache. The person who has referred this to me is a self-funded retiree and he relies on that interest from those investments to actually live. Of course, he is not getting interest. Now he may get a dribble of his principal back over time, as you have mentioned, Mr D'Aloisio, but with no interest. You should never assume, but I assume that the Colonial First State mortgage income fund is owned by the Commonwealth Bank. They are not paying interest. That is what has been brought to my attention. I assume it is correct—once

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

1 June – 3 June 2010

again, we should not assume. Is that not a breach of contract with the investor? You invest your money and all of a sudden the organisation is frozen and you are not getting interest back. Would that not be a breach of contract?

Mr D'Aloisio—Senator, I am happy to look at it. I do not remember the details, so I would like to take it on board. But, in general speak, it will depend on the terms of the constituent documents and what they say in certain events and what a manager and trustee can do. So there will be a legal answer. I do not have it with me. I would need to look at it.

Senator WILLIAMS—It would be good if you could get that. I would appreciate that.

Answer:

If the mortgage fund to which you are referring is the Colonial First State Mortgage Income Fund, it is operated by Colonial First State Investments Limited (Colonial First State) which is part of the Commonwealth Bank Group. They operate a number of funds that primarily invest in mortgages.

Mortgage funds are not deposits and do not ordinarily pay interest. This type of fund delivers a return to investors by way of distributions on the basis of the return the fund earns from lending to third parties.

In October 2008 Colonial First State suspended funds with investments in mortgages but continued to pay distributions. The Colonial First State Mortgage Income Fund, which as of February 2010 had \$852m in funds under management, primarily invested in commercial mortgages. Colonial First State announced in February 2010 that it had completed a review of the Fund and concluded it was in the best interests of investors as a whole to terminate the fund and begin the process of returning capital to investors. Colonial First State have told investors they intend to make quarterly payments to investors dependent upon the amount of cash available from mortgage repayments. The first payment was made in March and it is expected to take 4 years to realise all assets.

In February 2010, when announcing the wind-up of the fund, Colonial publicly stated that there would be no distributions until provisions for loan defaults had been recouped. This may be an attempt to ensure that there is no capital loss suffered by investors. Mortgage funds lend money to borrowers and the funds are dependent upon the receipt of regular interest inflows and repayment of the loan principal at the end of the term in order to pay distributions. If there are delays in the receipt of interest or the loan is not repaid on time, the fund may not be able to pay distributions.

ASIC has no role in the decision of Colonial First State to continue to pay distributions. This is a matter for the board of the responsible entity of the fund. Of course, Colonial First State must always act in the best interests of investors when making decisions on behalf of fund members, including as to whether to pay distributions or not.