

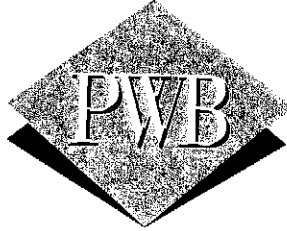


Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (a)

Submission No. 163

Submittor: Piggott Wood & Baker
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PIGGOTT WOOD & BAKER
Barristers & Solicitors

DMS:KNS:

16 May 2001

Attachments held
by Secretariat
available on request

Attention: Anne O'Connell
Senate Select Committee
on Superannuation and Financial Services

Fax: (02) 62773130

Dear Madam

Please find enclosed Piggott Wood and Baker's written submissions.

I can confirm that we do not intend to appear in person at the sitting of the Committee in Hobart on the 18th May, 2001.

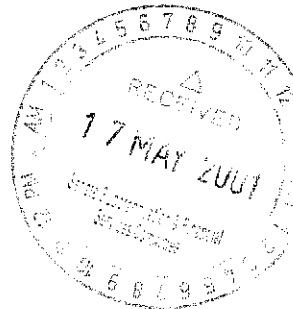
If you require any further information then please do not hesitate to contact me.

Yours faithfully
PIGGOTT WOOD & BAKER

Per:

DAVID SMITH

Direct e-mail: dsmith@pwb.com.au



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**SUBMISSION BY PIGGOTT WOOD & BAKER TO THE SENATE
SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL
SERVICES INQUIRING INTO THE PRUDENTIAL SUPERVISION
AND CONSUMER PROTECTION ISSUES IN RELATION TO THE
SOLICITOR MORTGAGE SCHEMES IN TASMANIA**

1. Many legal firms in Tasmania have for decades operated so called mortgage funds. The operation of a "mortgage fund" was considered part and parcel of the Tasmanian firms' commercial legal practice. Like others Piggott Wood & Baker operated a mortgage fund for a considerable time.
2. Generally speaking there were two styles of operation of a solicitors mortgage fund. The first was a "contributory mortgage fund" and the second a "pooled mortgage fund". In Tasmania, until recently, nearly all firms operated contributory mortgage funds with only a handful of pooled funds being available.
3. The Piggott Wood & Baker mortgage fund was a contributory mortgage fund. The operators of all such solicitors mortgage funds were required to be registered with the Law Society of Tasmania and operate their mortgage investment funds in accordance with regulations called the "Rules of Practice 1994" which are regulations made under the Legal Profession Act 1993. More recently solicitors' mortgage fund operators have also had to comply with the Managed Investment Provisions of the Corporations Law.
4. In simple terms, the Rules of Practice require that money received for investment by a controlled fund operator may only be lent provided that:
 - The loan is secured by a mortgage over real estate in Tasmania;
and
 - The amount of the loan does not exceed 66% of the security value of the mortgaged real estate or 50% of the current Government valuation of the mortgaged real estate.

The security value is determined by a valuation in writing obtained (from a registered real estate valuer) not more than three months before the date of the mortgage.

Attached is a copy of the relevant Rules of Practice taken from the Solicitors Handbook.

5. Solicitors mortgage funds are not guaranteed by the Law Society of Tasmania. The Legal Profession Act 1993 does, however, provide for a body known as the Solicitors Trust to administer a fund called the Solicitors Guarantee Fund. The Solicitors Guarantee Fund exists to, among other things, meet claims by people who have lost money as a result of a defalcation, misappropriation or misapplication of their funds by a solicitor. The Solicitors Guarantee Fund does not and will not meet claims by people who may have suffered a loss arising, for example, from a fall in the value of real estate [and the default of a borrower].

In 1998/1999 the Law Society acting on a request from Piggott Wood & Baker undertook a thorough investigation of the Piggott Wood & Baker mortgage fund. Unlike some other solicitor mortgage funds the investigation did not result in any application for a default order such that the fund might be brought within the province of the Solicitors Guarantee Fund. The outcome of the investigation therefore indicated that the operation of the Piggott Wood & Baker operation of its mortgage fund was consistent with and in compliance with the Rules of Practice.

6. When funds were received for investment by Piggott Wood & Baker they were, so far as possible, matched up with requests for funds from potential borrowers. Frequently the funds of a number of different investors were combined to make up one loan, the whole of which was then secured by a single mortgage as described above. The mortgage was given, in Piggott Wood & Baker's case, to two of the partners as trustees for the investors whose funds made up the loan. This is the arrangement that is commonly called a "contributory mortgage" loan.

7. Investors were advised of the identity of the borrower of their invested funds when they achieved their quarterly statements and interest payments.
8. Each borrower was required to pay interest (usually quarterly) and that interest (minus a collection charge) was paid to investors in proportion to their investment in the loan. The terms of the borrower's obligations were set out in the mortgage document. Attached is a copy of a pro forma mortgage which was in common use.
9. A contributory mortgage loan differs from a deposit with a bank or other financial institution in at least two important ways:
 - (a) First, interest is only payable to investors as and when it is received from borrowers. Unlike a bank a controlled fund operator has no contractual obligation to pay interest to investors if the interest has not been paid by the borrower; and
 - (b) Secondly, the failure of one borrower to pay interest on his or her loan has absolutely no effect upon any investor who does not have money in that loan. In that sense it may be confusing to talk of a mortgage investment fund. There is no "fund" as such, merely a number of separate and distinct loans each with its own investors whose funds are secured by one or more mortgages specific to that loan and each dependent upon a particular borrower paying interest as and when it falls due.
10. Solicitors mortgage funds in Tasmania are and have been for some time the subject of regular audit by the Law Society.
11. The operation of Tasmanian solicitors mortgage funds was significantly changed by the Managed Investment Act (Commonwealth) which commenced on 1 July 1998. For some time solicitors mortgage funds had been subject to Corporations Law provisions, particularly provisions relating to prescribed interests and prospectuses. Equally for some time solicitors mortgage funds had had the benefit of various exemptions

from these provisions. For example, the ASC (as it was) issued Class Order 92/843 on 30 July 1992. That Class Order exempted solicitor-run mortgage funds from the prospectus, debenture and share hawking provisions of the Corporations Law. The exemption was made subject to a number of conditions. The exempted funds were those carried out (amongst others) under the supervision of the Law Society of Tasmania. To be eligible for the exemption a fund had to invest deposited money only in deposits with an Australian bank or in loans secured by a mortgage of lands in Australia that was valued at at least 125% of the loan or if the mortgaged loan were insured, at not less than 105% of the loan. Attached are copies of a number of the Class Orders made between 1992 and the present.

12. There is of course an inconsistency between the loan to value ratios required by the Rules of Practice and those required by the ASIC exemptions. The Rules of Practice provided for a more conservative loan to value ratio. It is that more conservative ratio that solicitors in Tasmania were required to adopt and which was adopted by Piggott Wood & Baker.
13. In 1997 the ASIC undertook a review of the effectiveness of the regulatory regime applying to mortgage investment schemes throughout Australia. A number of issues were raised by that review. As a result of that review and of the new system of regulation of managed investment schemes following amendment of the Corporations Law (which commenced on 1 July 1998), ASIC reconsidered its position and formulated an alternative regulatory framework for mortgage funds. In summary, ASIC required that solicitors mortgage funds comply with Chapter 5C of the Corporations Law which in turn requires registration with ASIC of the scheme, a registered prospectus, a compliance plan, operation by a responsible entity and other requirements. Those requirements applied from 1 April 1999. Some transitional relief was afforded to operators who elected to wind-up their funds.

14. Particularly in the light of the ASIC requirements, which were seen as financially burdensome for small funds, in November 1998 Piggott Wood & Baker decided to cease the operation of its mortgage fund, transfer its loans, where possible, to a complying fund and run out the balance of the loans during the transitional period.
15. About the same time Piggott Wood & Baker also decided to cease its practice of advancing unpaid interest to investors. Prior to that time it had been the firm's practice to advance interest in respect of any loan where interest payments had not been paid by the due date. This was naturally advantageous to investors in that they knew that they would receive their proportionate interest from a loan (on particular dates). The decision to cease advancing interest only affected those investors in loans where the borrower had failed to pay interest or had paid late. The decision had no effect on other investors and particularly on investors in the great majority of loans in the Piggott Wood & Baker mortgage fund where borrowers continued to pay their interest on time.
16. Having decided to cease operation of its mortgage fund Piggott Wood & Baker assisted Perpetual Trustees (Tasmania) Ltd in setting up a new pooled fund called the Tasmania Select Mortgage Fund. A significant proportion of the Piggott Wood & Baker fund was then transferred into that fund. Other solicitors in Tasmania also transferred significant proportions of their funds into The Tas Select Mortgage Fund. In relation to the remaining loans Piggott Wood & Baker made demand of borrowers requiring them to refinance or realise security properties to enable repayment of the loan. In many cases this resulted in a mortgagee's sale being necessary. This has been a difficult process in a depressed property market. Careful management has been required to ensure that reasonable sale prices have been achieved so as not to disadvantage investors.

17. By the above process approximately 80% of the Piggott Wood & Baker loans have now been repaid or transferred. Work continues to finalise all remaining loans.
18. Piggott Wood & Baker has been in regular contact with all remaining investors in relation to the run-out of loans. In this regard Piggott Wood & Baker undertook from 1998 the following initiatives:

(a) **Review of Borrowers**

- (i) The firm engaged Vern Robinson, a senior and experienced Chartered Accountant, to review the processes which the firm had in place in relation to dealing with borrowers. All affected investors were advised of the engagement of Mr Robinson and were invited to discuss matters with him.
- (ii) The firm also engaged Knight Frank to review marketing strategies and likely sale value in relation to all properties securing monies lent to borrowers whose interest was in arrears.

(b) **Status Reports to Affected Investors**

Every three months since December 1998 the firm has prepared and distributed to every affected investor a status report in relation to their investment(s). Each status report gives full details of the borrower, the borrowings and the security, as well as a summary of the action which was being taken by the firm to enforce the security.

(c) **Mortgage Information Desk**

The firm has maintained a mortgage information desk to provide up-to-date information to investors about the details of their loan

and security, as well as progress in enforcing any security against defaulting borrowers.

(d) No Fresh Investment Funds

In late 1998 the firm resolved not to accept fresh funds for investment except where a loan was repaid and an investor expressly consents to the reinvestment of those funds.

18. It is not correct to say that the residue of the Piggott Wood & Baker mortgage fund is lost to investors. Realisation of security properties is continuing. We have taken legal action against some valuers where we have been advised that there has been negligence of deficiencies in valuation methodology.
19. Piggott Wood & Baker has at all times cooperated with ASIC in its Australian-wide investigation of mortgage funds.
20. Until the Piggott Wood & Baker mortgage fund is fully run out the firm will continue to keep investors fully informed.

Dated the 15th day of May 2001.

PIGGOTT WOOD & BAKER