

Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (a)

Submission No. 198

(Supplementary to Submission No. 116)

Submittor: Australian Securities and
Investments Commission (ASIC)
Mr David Knott
Chairman
GPO Box 5179AA
MELBOURNE VIC 3001
 - (03) 9280 3323
 - (03) 9280 3325



***THE AUSTRALIAN SECURITIES AND
INVESTMENTS COMMISSION'S SUBMISSION
TO THE SELECT COMMITTEE ON SUPERANNUATION
AND FINANCIAL SERVICES***

6 June 2001

1. INTRODUCTION

The Senate Select Committee on Superannuation and Financial Services is conducting an enquiry into prudential supervision and consumer protection for superannuation banking and financial services. As part of this enquiry, the Chair of the Committee, Senator John Watson has invited interested organizations and individuals to lodge submissions on Solicitors Mortgage Schemes in Tasmania.

This submission summarises the regime put in place by the Corporations Law ("CL") for the regulation of mortgage schemes. The application of the CL is impacted in a number of respects by the policies of the Australian Securities and Investments Commission ("ASIC") and its predecessor regulator, the Australian Securities Commission ("ASC"). Whilst most of the comments apply nationally, this submission focuses on the application of the regulations in Tasmania, which is the particular focus of the Enquiry.

Coverage of this submission

The term "mortgages", "mortgage business" or "solicitors mortgage schemes" as used in this submission, covers a range of investment activity whereby investors (mortgagees) lend¹ money to a borrower (mortgagor) secured over real property. If the borrower defaults on the payment of interest or principal then the security can be exercised and the real property sold to satisfy the borrower's liabilities to the investors. There are two principal structures adopted:

- Pooled mortgages – whereby investors money is pooled and invested generally across a range of mortgages, and
- Contributory mortgages – whereby one or more investors lend their money directly to a designated borrower. Often the lenders names will be recorded directly on the mortgage otherwise the lenders interests will be recorded through a nominee company.

Contributory mortgages are typically for a reasonably short period such as two years, although this can of course vary. In Tasmania some mortgages are "on demand" and can last for a very long time (over 80 years). A frequent practice at the end of a mortgage term is that the mortgage is "rolled over", meaning that the investors agree to extend the term of the loan for another period.

History of the regulation of mortgage schemes

The ASC took the view in the early 1990s that mortgage businesses were probably not prescribed interest schemes (which were regulated by the ASC under the Corporations Law ("CL")) unless they involved pooling of client funds. As the industry then was, that meant that far fewer schemes were caught than is now the case.

¹ The terms "lend" and "invest" are used interchangeably in this paper

During the 1990s, the industry grew very rapidly, and mortgage operators developed new business practices. The ASC formed the view that pooling had become more common and this position was the basis of the ASC's public hearing in 1992 and the development of class order relief that applied initially to solicitors in the eastern states (supervised by the relevant state law bodies). Subsequently, in 1995 class order relief was also granted to South Australian finance brokers supervised by the Finance Brokers Institute of South Australia.

Towards the end of 1996 and early in 1997, the ASC was approached in Western Australia for relief similar to that granted to the South Australian finance brokers. At that time, significant losses from mortgage investments had come to light, especially in South Australia and New South Wales. The ASC became concerned that the class order relief for supervised solicitors' schemes (and supervised finance brokers' schemes in South Australia) was not delivering the desired regulatory effect and ASIC commissioned a report by an industry expert.

In September 1997, the industry expert reported on the state of the industry in states where operators were subject to class order arrangements, and on the adequacy of the regulatory arrangements. The report proposed a range of measures dealing with

- Investor protection,
- Audit and surveillance, and
- Regulatory arrangements.

Acting on that report, the ASC commenced a review of the policy it had adopted to that point. Finalisation of this policy was subject to some delay because of the introduction of the new managed investments legislation. The new legislation made some changes to the scope of what mortgage-related activity is caught as regulated managed investment activity and altered, in a fundamental way, the regulation that applied to managed investment operators.

Consultation on new policy extended from October 1998 to March 1999 and ASIC published a final policy in March 2000.

The starting point of the new policy is that all mortgage activity that amounts to a managed investment should be directly regulated through the CL regime. It permits a limited exception for small scale schemes that are subject to adequate supervision by an approved industry body. The policy indicates that industry bodies seeking to play a supervisory role will be subject to rigorous testing.

Part of the transitional arrangements for the implementation of this new policy included a requirement for existing practices, which did not wish to, or could not, comply with the new arrangements to bring the scheme to an end. These schemes were to be run out by November 2001 under the supervision of the existing supervisory regime (ie. in Tasmania, under the supervision of the Law Society of Tasmania). No new interests could be created in these schemes although in very limited circumstances existing loans can be rolled over.

In late 2000, ASIC became aware that there were significant levels of defaults in these "run out" schemes and ASIC had concerns about the way that these defaulting

mortgages were being managed. In February 2001, ASIC announced a major enquiry into these run out practices and appointed Tony Hodgson, one of Australia's leading insolvency experts to assist with that task. That enquiry is still ongoing.

This submission describes the position at law, the evolution of policy, and summarises ASIC's actions with respect to mortgage investment schemes in Australia, but with a particular emphasis since the commencement of the Managed Investments Act in 1998.

Content of this submission

The paper is divided into three parts of which this Introduction forms Part 1.

Part 2 sets out the legislative and policy position under the prescribed interest regime, provides a summary of ASIC's surveillance and enforcement action initiated during this period and outlines concerns identified as a result of these activities.

Part 3 outlines the legislative and policy position upon, and subsequent to, the introduction of the Managed Investments Act (Cwth), the action ASIC has taken to achieve compliance by the mortgage investment industry with CL Chapter 5C, and ASIC's current and future strategy with respect to the surveillance of the mortgage industry.

Part 4 summarises ASIC's understanding of the mortgage industry in Tasmania, and details some of the matters which ASIC is enquiring into.

2. POSITION PRIOR TO THE MANAGED INVESTMENTS ACT

2.1 LEGISLATIVE POSITION WITH REGARD TO PRESCRIBED INTERESTS

Prior to the introduction of CL Chapter 5C on 1 July 1998, the CL regulated “prescribed interests”. “Prescribed interests” were “securities” under the CL. A prescribed interest included, under the then CL s9, a “participation interest”.

“Participation interest” had a broad inclusive definition under the CL, with specific listed exclusions. The inclusive part of the definition was as follows:

“participation interest means any right to participate, or any interest:

- (a) in any profits, assets or realisation of any financial or business undertaking or scheme whether in Australia or elsewhere;
- (b) in any common enterprise, whether in Australia or elsewhere, in relation to which the holder of the right or interest is led to expect profits, rent or interest from the efforts of the promoter of the enterprise or a third party; or
- (c) in any investment contract;

whether or not the right or interest is enforceable, whether the right or interest is actual, prospective or contingent, whether or not the right or interest is evidenced by a formal document and whether or not the right or interest relates to a physical asset.”

The regulatory regime for prescribed interests essentially comprised the approval of deeds by the ASC, the approval of trustees by the ASC, the licensing of the manager by the ASC and the inclusion of a large number of prescribed covenants in the trust deed. The trustee held custody of the property of the prescribed interest scheme or enterprise. The management company’s covenants to the trustee and investors included striving to conduct its business in a proper and efficient manner. Prescribed interests could not be issued or offered for subscription or purchase unless there was in force an approved deed in relation to the prescribed interest.

Depending on the individual structure adopted, mortgage businesses may have involved the issuing or offering of prescribed interests, specifically participation interests. However the ASC issued class-order exemptions in most states relieving private mortgage businesses from having to comply with the prescribed interest provisions of the CL. Instead, such business was subject to regulation by bodies such as the respective state law societies or equivalents. This relief was granted on the basis of submissions that adequate alternative regulatory arrangements existed or would be put in place.

In relation to Tasmania for example, by a submission dated 7th August 1991, the Law Society of Tasmania recommended that mortgage investments operated in conjunction with solicitors practices should be relieved from the obligations of the Corporations Law. That submission referred to the role of the Society in overseeing the conduct of solicitors in handling of trust monies. That submission said:

" Those regulatory practices have much in common with the role of your Commission in the community. It proclaims standards of conduct to be observed within the community and seeks to ensure that those standards are adhered to and, if not adhered to, seeks to invoke disciplinary remedies against those responsible.

However, at a second level, the society has long recognised that such endeavours, no matter how efficiently and diligently enforced, will never totally prevent malpractice and the losses occasioned thereby.

But what is more important is that, recognising that losses will from time to time occur despite the best efforts of organizations such as that of your Commission and this Society, the Society has the capacity to make substantial provision to ensure that when such losses to arise that the members of the public will be indemnified if the losses are occasioned by culpable action or omissions on the part of practitioners."

2.2 EARLY ASC INVOLVEMENT

In 1992, the ASC held public hearings on a national basis into solicitors' mortgage schemes. As a result of this, class order relief was given to such schemes in New South Wales, Victoria and Tasmania in 1992, Queensland in 1994 and South Australia in 1995. This relief exempted solicitors' mortgage schemes (and finance brokers' schemes in South Australia) from compliance with the prescribed interest provisions of the CL subject to there being adequate supervisory and indemnity arrangements in place with the relevant supervisory bodies.

In 1997, ASC commissioned a report from Balamay Pty Ltd on mortgage schemes after the failure of some mortgage schemes with class order relief in NSW and Queensland. The ASC became concerned that the Class Order relief for supervised solicitors and finance brokers' schemes in SA was not suitable.

The Balamay Pty Ltd *'Report on Solicitors' Mortgage Investment Industry'* dated September 1997 reported on the state of the industry in states where operators were subject to class order arrangements and on the adequacy of regulatory arrangements.

Based on the findings of the Balamay Report, which proposed a range of measures dealing with investor protection, audit and surveillance, and regulatory arrangements, the ASC commenced a review of the policy it had adopted. This review of policy was affected by the development of ASIC's jurisdiction over mortgage schemes (particularly from late 1998) due to the introduction of the Managed Investments Act 1998. This involved changes to the scope of what mortgage related activity was caught as a regulated managed investment scheme and altered in a fundamental way the regulation that applies to managed investment operators.

In October 1998, ASIC released a policy proposal paper on "Mortgage Investment Schemes" for public and industry comment and discussion. The paper was about how the managed investment and fund raising provisions of the CL should apply to mortgage schemes.

(THE POLICY PROPOSAL PAPER IS ATTACHED AS ANNEXURE 1)

In February 1999, ASIC published a Media Release and an Information Release setting out ASIC's preliminary position on the future regulation of mortgage investment schemes and seeking public comment. This preliminary position provided for only limited relief for large schemes from fundraising provisions, but greater relief for small schemes where there was an adequate alternative supervisory regime in place.

(THE MEDIA & INFORMATION RELEASES ARE ATTACHED AS ANNEXURES 2&3)

The growth in the size of the mortgage investment scheme sector and problems experienced by investors in some of these schemes resulted in ASIC, in July 1999, clarifying their regulation under the new Managed Investments Act 1998 (Cth).

ASIC released PS 144 outlining the new regulatory structure that mortgage investment schemes have to operate under in order to ensure consumer protection for people who have invested in these schemes. The new policy was originally scheduled to begin by 1 November 1999; however following further consultation with industry this was extended to 17 December 1999.

The new policy brings the regulation of mortgages more directly under the managed investments provisions of the CL than provided under previous relief. Although law bodies and other professional organisations, such as finance broker associations, traditionally supervised mortgage investments, ASIC decided to move regulation of these schemes onto a footing more in common with other managed investment schemes:

- (i) as many legal practitioners and, in some states, finance brokers, were now operating large commercial mortgage practices with substantial funds under their management; and
- (ii) due to serious concerns by investors regarding some recent industry failures.

Under the new policy, mortgage investment schemes are required to comply with the managed investment provisions of the CL, ie Chapter 5C.

In March 2000, ASIC released final policy statement PS 144 in substantially the same terms as the interim policy and, subsequently in April, ASIC issued an information release and media release providing clarification to mortgage scheme operators about, inter alia, the indicia of a managed investment scheme, requirements to meet exemptions and the use of risky valuations.

(POLICY STATEMENT 144 IS ATTACHED AS ANNEXURE 4)

3. THE POSITION UNDER THE MANAGED INVESTMENTS REGIME

3.1 MORTGAGE OPERATIONS CAUGHT AS MANAGED INVESTMENTS

CL Chapter 5C contains the regulatory regime for registered managed investment schemes. A person commits an offence under CL s601ED(5) if it operates a managed investment scheme that requires to be registered under CL s601EB unless the scheme is registered.

In summary, a registered managed investment scheme must be operated by a "responsible entity". CL Part 5C.2 imposes various duties on both the responsible entity of the registered scheme and on the officers of the responsible entity. Additionally, the provisions of the scheme's constitution must satisfy the requirements of CL Part 5C.3. Registration of a managed investment scheme also requires the lodgement of a compliance plan which must meet CL Part 5C.4.

A managed investment scheme is defined in CL s9 as;

"(a) a scheme that has the following features:

- (i) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);
- (ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);
- (iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions)."

Mortgage business traditionally conducted by solicitors and mortgage brokers or finance brokers may at times be characterised as exhibiting the above features. In general, ASIC believes that when applying the definition of a managed investment scheme to the activities of a mortgage business, the focus should be on the nature of the services provided and the operator's involvement in the commercial decisions surrounding a mortgage transaction.

Factors Which May be Indicative of a Managed Investment scheme

The following are examples of practices which ASIC believes may indicate that the legal or commercial character of the investments represent managed investment schemes:

- (i) money contributed by different investors is lent under one mortgage;

- (ii) mortgages are taken in the name of a nominee in order to facilitate management or transfer the investor's interest; or
- (iii) the availability of borrowers, securities or particular terms depends on the scale and continuity of the business.

The extent to which commercial decisions are made by the operator and not the investors may be such that a mortgage investment amounts to a managed investment scheme. The following are examples of such decisions:

- (i) an operator routinely makes investment decisions under general authority, or decides whether to extend loans or enforce securities without referring decisions to investors;
- (ii) an operator is responsible for obtaining or determining valuations and approving lending against those valuations, making decisions about how and when repayments will be made or what action will be taken on default;
- (iii) the operator advertises for new investors to loan money stating the amount to be lent and the loan-to-value ratio of the loan and investors relying upon this enter into loans; or
- (iv) the operator matches investors to new loans, such as allocating two investors contributing \$50,000 each to a \$100,000 loan.

Factors Which do Not Suggest That a Managed Investment Scheme is Present

Some practices will not involve the operation of a managed investment scheme. Some of the indicia of a scheme that is not a managed investment scheme include the following:

- (i) a solicitor documents a security and settles an advance under the instructions of a person who makes their own bargain. This is unlikely to constitute a managed investment scheme even if the solicitor is acting as a "post box" for interest payments; or
- (ii) all decisions in the process are made by the investors individually. This includes the investor making its own decisions on the value of the property and the credit-worthiness of the borrower.

Regulatory Focus on the Service Provider

The implementation of the managed investment scheme definition in CL s9 to mortgage business activity may often produce the result that conceptually, a particular business comprises the operation of several managed investment schemes. Rather than requiring the registration of each such scheme, it is ASIC's policy, as outlined in ASIC Policy Statement 144, that a responsible entity may register a single scheme to cover the

provision of multiple mortgages. Under the CL, the responsible entity must be a public company that has been licensed by ASIC to operate a managed investment scheme.

CL s601ED - When a Managed Investment Scheme is Required to be Registered

In view of its policy of allowing registration of one managed investment scheme for the purposes of carrying on a mortgage business, ASIC has adapted the manner in which CL s601ED will apply to determine whether the scheme must be registered. Registration of a managed investment scheme imports, amongst other things, the regulatory regime for managed investment schemes contained in CL Chapter 5C.

CL s601ED(1)(a) requires a managed investment scheme to be registered if it has more than 20 members. CL s601ED(1)(b) requires registration if the scheme was promoted by a person, or an associate of a person, who was, when the scheme was promoted, in the business of promoting managed investment schemes (even if there are less than twenty members in the scheme).

ASIC relief has clarified the operation of CL s601ED(1)(b), to the effect that a person will not be taken as being in the business of promoting mortgage investment schemes unless the total number of investors in the mortgage practice taken as a whole is more than twenty or unless the operator or its associates are operating other mortgage practices.

Where a nominee company represents investors, the investors themselves are counted as members of the scheme, rather than the nominee company.

Small-Industry Supervised Schemes

With the activities of many mortgage businesses in effect being caught as managed investment schemes which must be registered, ASIC has provided flexibility in its policy that will relieve some business operators from having to register a managed investment scheme. In doing so, ASIC has endeavoured to ensure that the regulatory outcomes embodied in CL Chapter 5C are nonetheless achieved.

ASIC Class Order CO 00/203 sets down the conditions on which relief is given to operators of mortgage businesses from registering a managed investment scheme. Relief for 'small-industry supervised schemes' essentially involves the operation of a mortgage business whose total principal of loans does not exceed \$7.5million, under the supervision of an approved 'industry supervisory body' (ISB).

ASIC approves an ISB subject to published criteria. For instance, the relevant body must have ongoing supervisory rules for mortgage operators' financial position, record keeping, valuation practices, insurance and dispute resolution procedures. Only the Law Society of New South Wales and the Law Institute of Victoria have applied for approval, which has been granted subject to compliance with our policy requirements.

Run out schemes

Relief for 'run-out schemes' is available until 31 October 2001. This provides mortgage business operators who do not wish to register a managed investment scheme with time to bring their existing operation to an end, or alternatively run the business down so that it will qualify as a small industry supervised scheme or become a scheme with less than 20 members. A run-out scheme must comply with the conditions specified in CO 00/203 and also be supervised by an ISB.

3.2 REGISTRATION PROCEDURES FOR MANAGED INVESTMENTS

Upon receiving an application to register a managed investment scheme, ASIC must, under CL s601EB, register the scheme;

“... unless it appears to ASIC that:

- (c) the application does not comply with section 601EA; or
- (d) the proposed responsible entity does not meet the requirements of section 601FA; or
- (e) the scheme's constitution does not meet the requirements of sections 601GA and 601GB; or
- (f) the scheme's compliance plan does not meet the requirements of section 601HA; or
- (g) the copy of the compliance plan lodged with the application is not signed as required by section 601HC; or
- (h) arrangements are not in place that will satisfy the requirements of section 601HG in relation to audit of compliance with the plan.”

In relation to paragraph (d) of CL s601EB(1) above, CL s601FA provides that the responsible entity of a registered scheme must be a public company that holds a dealers licence authorising it to operate a managed investment scheme.

The Responsible Entity

Under CL s601FB(1), it is the responsible entity of a registered scheme that is to operate the scheme and perform the functions conferred on it by the scheme's constitution and the CL. The responsible entity holds the scheme property on trust for scheme members: CL s601FC(2). Nevertheless, the responsible entity is empowered to appoint an agent or otherwise engage a person to do anything that it is authorised to do in connection with the scheme: CL s601FB(2).

ASIC grants and administers dealers licences in accordance with the provisions of Part 7.3 of the Law. CL s784(2) sets out when ASIC is required to grant a licence.

Education and Experience of Responsible Officers

The education and experience elements for the granting of a dealers licence to operate a managed investment scheme are jointly encompassed in ASIC Policy Statement 130 and ASIC Policy Statement 138. Paragraph 51 of PS 130 contains ASIC's educational and experience standards in relation to:

- (i) investing or operating the kinds of scheme assets that are to be managed by a scheme; and
- (ii) operating a managed investment scheme and understanding the obligations of a licensee, including the duties and responsibilities of a responsible entity.

(POLICY STATEMENT 130 IS ATTACHED AS ANNEXURE 5)

Financial Requirements

CL s784(2A) provides that:

“For the purpose of paragraph (2)(e), the ASIC must be satisfied that the value of the net tangible assets of the applicant is and will be maintained at a minimum of \$50,000 or, where the value of all scheme property is greater than \$10,000,000, an amount equal to 0.5% of those assets shown in the latest accounts of the scheme lodged with the ASIC, up to a maximum of \$5,000,000.”

“Net Tangible Assets” (“NTA”) is defined in CL s784(2C):

“In this section:

“net tangible assets” means the total tangible assets of the applicant, including any guarantee approved by the ASIC, less any adjusted liabilities as shown in the latest accounts of the applicant lodged with the ASIC.”

CL s784(2B) expresses the discretion in ASIC to prescribe additional requirements that must be met by a body corporate applying for a licence to operate a managed investment scheme:

“ASIC may determine additional requirements for the purpose of paragraph (2)(e), including, but not limited to, a requirement that scheme property be held by an agent in particular circumstances.”

ASIC Policy Statement 131 provides guidance on both the financial requirements that a responsible entity must satisfy when applying for a licence to operate a managed investment scheme, and on the calculation of NTA. As well as meeting the mandatory NTA level of CL s784(2A), an applicant responsible entity must:

- (a) have access to sufficient financial resources (including from its entitlements from scheme property, such as fees) to meet ongoing

scheme-related cash requirements which would arise under reasonably foreseeable circumstances, for a minimum of three months; and

- (b) maintain appropriate professional indemnity insurance and insurance against fraud of its officers. This should cover claims up to, and in aggregate, \$5 million, or the value of scheme assets, whichever is less (unless the responsible entity can demonstrate to ASIC that such insurance is not reasonably obtainable).

The mandatory NTA level, sufficient financial resources requirement and holding of the necessary insurance are imposed on the responsible entity on an ongoing basis as conditions of the responsible entity's licence. ASIC's power to place conditions on a licence is contained in CL s786.

Custodial Requirements

Pursuant to CL s784(2B), ASIC describes in PS 131 the circumstances in which the scheme property of a managed investment scheme must be held by an agent, and the NTA that any such scheme property custodian must have.

Again, when a custodian must be used for holding scheme property, and the appropriate NTA of that custodian, are imposed as conditions of the licence of a responsible entity. Generally, many mortgage scheme operators will not be compelled to engage a scheme property custodian.

In a mortgage scheme where the investors hold title to the mortgaged property, no external custodian for scheme property is required and the responsible entity itself is only required to maintain the statutory NTA of \$50,000. Generally, this reflects the relatively low risk of the benefit of investors' rights under their mortgage being misappropriated or assigned without their consent. The requirements on sufficient financial resources and professional indemnity and fraud insurance remain applicable.

A mortgage scheme structured so that the mortgage is held in the name of the responsible entity may be able to hold scheme property itself provided it has a minimum of \$500,000 in NTA.

In cases other than those set out in the previous two paragraphs, the custodian must have \$5 million NTA.

Constitution of a Registered Scheme

In determining whether to register a managed investment scheme, ASIC must assess whether the scheme's constitution meets the requirements of CL s601GA and s601GB. These sections are reproduced below:

"601GA. Contents of the constitution

- (1) The constitution of a registered scheme must make adequate provision for:

- (a) the consideration that is to be paid to acquire an interest in the scheme; and
 - (b) the powers of the responsible entity in relation to making investments of, or otherwise dealing with, scheme property; and
 - (c) the method by which complaints made by members in relation to the scheme are to be dealt with; and
 - (d) winding up the scheme.
- (2) If the responsible entity is to have any rights to be paid fees out of scheme property, or to be indemnified out of scheme property for liabilities or expenses incurred in relation to the performance of its duties, those rights:
- (a) must be specified in the scheme's constitution; and
 - (b) must be available only in relation to the proper performance of those duties; and
 - (c) any other agreement or arrangement has no effect to the extent that it purports to confer such a right.
- (3) If the responsible entity is to have any powers to borrow or raise money for the purposes of the scheme:
- (a) those powers must be specified in the scheme's constitution; and
 - (b) any other agreement or arrangement has no effect to the extent that it purports to confer such a power.
- (4) If members are to have a right to withdraw from the scheme, the scheme's constitution must:
- (a) specify the right; and
 - (b) if the right may be exercised while the scheme is liquid (as defined in section 601KA)--set out adequate procedures for making and dealing with withdrawal requests; and
 - (c) if the right may be exercised while the scheme is not liquid (as defined in section 601KA)---provide for the right to be exercised in accordance with Part 5C.6 and set out any other adequate procedures (consistent with that Part) that are to apply to making and dealing with withdrawal requests.

The right to withdraw, and any provisions in the constitution setting out procedures for making and dealing with withdrawal requests, must be fair to all members.

601GB. Constitution must be legally enforceable

The constitution of a registered scheme must be contained in a document that is legally enforceable as between the members and the responsible entity.”

Policy Statement 134 provides guidance on, amongst other things, how ASIC will decide whether a constitution makes adequate provision for the matters listed in CL s601GA(1).

Compliance Plan of a Registered Scheme

CL s601HA(1) provides that the compliance plan of a registered scheme must set out adequate measures that the responsible entity is to apply in operating the scheme to ensure compliance with this Law and the scheme's constitution. The subsection then goes on to list specific matters, which are to be addressed in the compliance plan.

Policy Statement 132 contains guidance on what should be contained in a compliance plan. Essentially, the policy statement requires that the measures in a compliance plan must represent more than mere platitudes or broad ambitions of compliance on the one hand, but they should not include every step, check, procedure or action on the other hand. The test indicated is that the plan must describe the compliance activities with enough detail and certainty for the auditor and for ASIC to assess, at a later time, whether the plan has been complied with.

ASIC is empowered by CL s601FF to conduct surveillance checks from time to time, in order to ascertain whether the responsible entity of a registered scheme is complying with the scheme's constitution, compliance plan and the CL.

Fundraising

ASIC's policy on the application of the fundraising provisions to mortgage investment schemes provides class-order relief to allow mortgage operators to use a two-stage prospectus.

1. The contents of the 'general prospectus' of a mortgage scheme, must together satisfy:
 - (a) the disclosure requirements of CL Division 4 of Part 6D.2; and
 - (b) the disclosure requirements of ASIC Class Order 00/202, being information about:
 - (i) the scheme's constitution and the responsible entity; and
 - (ii) the general operations of the scheme and the general character of the interests in the scheme, including the main features of mortgage lending under the scheme, the relationship between the offeror of interests in the scheme and investors, the rights of a lender, the fees and charges that will apply and the valuation practices the offeror will use.

The general prospectus of a mortgage scheme must be lodged with ASIC.

2. Class order CO 00/202 goes on to require a mortgage scheme operator to issue a 'specific prospectus' for each mortgage that is made available for investment. A specific prospectus should be read by a potential investor with the scheme's general prospectus. The specific prospectus does not have to be lodged with ASIC.

A specific prospectus must contain the information required by CL Division 4 of Part 6D.2 as is specifically relevant to scheme interests pertaining to the mortgage investment to which that specific prospectus relates, including, but not limited to:

- (i) the borrower offering the mortgage, including their creditworthiness;
- (ii) the mortgage itself and the rights that accrue under it;
- (iii) the property that is to be mortgaged, how it has been valued and what is its value;
- (iv) the loan to valuation ratio;
- (v) any prior securities the property is subject to;
- (vi) the interest the borrower will pay; and
- (vii) how long the loan will last and the arrangements for repayment of it.

This approach also ensures that in relation to a particular loan, private details about the borrower, the property and the terms of the transaction are not placed on the public register.

There may be some mortgage schemes for which a two-stage prospectus may be unnecessary. Typically, this would be where the operator makes all of the decisions about which mortgages are to be acquired. In such a case, a single prospectus that complies with the disclosure requirements in CL Part 6D.2 is likely to be sufficient.

3.3 ASIC'S NATIONAL SURVEILLANCE STRATEGY FOR MORTGAGE SCHEMES

Surveillance approach

ASIC undertakes a variety of surveillance strategies of the Managed Investments industry. Currently there are 72 entities licensed, whose primary business is to operate mortgage schemes. These mortgage operators represent 16% of all licensed Responsible Entities currently operating within the managed investment industry. Since the transition of solicitor mortgage operators to the MIA, ASIC has carried out 43 surveillance activities upon mortgage operators, representing 31% of all surveillances undertaken over that time period to date.

(A state by state breakdown of these numbers is provided in ANNEXURE 6)

In addition to its surveillance of registered scheme operators ASIC launched a major investigation in February 2001 into solicitors run-out mortgage schemes.

(A copy of ASIC media release 01/055 25 February 2001 is attached as ANNEXURE 7)

As part of that enquiry ASIC, with the assistance of Mr Tony Hodgson has visited nine run-out operators across Queensland, Tasmania and Victoria to review their operations. ASIC, in consultation with Mr Hodgson is currently reviewing the results of those enquiries to develop a strategy for dealing with a range of issues including:

- dealing with losses in run-out schemes
- setting new standards for conduct of ongoing registered managed investment schemes
- consideration of what if any further relief should be given to the extension of the run-out period (currently to expire on 31 October 2001) and
- methods by which defaulting run out loan books can be bought to a conclusion.

The focus of our surveillance strategy is to take a national approach so we can achieve consistency in the industry, but also have a clear regional surveillance agenda in order that specific local problems can be addressed in a timely manner.

Findings from surveillance visits

The main breaches identified from the surveillances over registered mortgage scheme operators were:

- Lack of, or poor, borrower assessment and loan approval practices. Identified as a breach of the compliance plan and Corporations Law.
- Non-compliance with NTA, cash flow and PI insurance requirements. Identified as a breach of the licence conditions.
- No evidence of a compliance monitoring and reporting procedure being undertaken. Identified as a breach of the compliance plans and subsequently the Corporations Law.
- Misleading information provided to investors, or potential investors.

The actions taken by ASIC to address these breaches depended on the nature of the breach and whether there were other issues or concerns identified during the surveillance activity. Of the completed surveillances, in 60% of cases ASIC took remedial action in response to the issues identified. The remedies employed by ASIC to address the breaches varied according to the significance of the breach and the level of risk to investors.

Where the breaches identified were considered by ASIC to be major, such as a breach of financial licence conditions or provision of misleading information to investors, remedial action was undertaken to either remove the RE or the scheme from the industry on either a temporary basis (using prospectus stop orders) or a permanent basis (by revoking the operators licence). To date ASIC has revoked the licence of 3 mortgage operators and stopped the fundraising activities of 6 mortgage schemes.

Other remedies ASIC has utilised to address compliance breaches have been directions to modify the scheme compliance plans and by placing additional conditions on the

licences of mortgage operator. Generally, the objectives of imposing additional licence conditions or requiring modification to a compliance plan has been to require boards and management of the mortgage operators to rectify the breach and undertake comprehensive reviews, using external independent consultants, of their compliance systems and controls to prevent re-occurrence of breaches. To date over 13 mortgage operators have been directed by ASIC to modify their compliance plans while over 7 licences of mortgage operators have attracted additional licence conditions.

Whilst not unique to mortgage operators, other issues identified relating to compliance and operations were as follows:

- In circumstances, where mortgage operators outsource services (generally legal) to a related party, service provider formal agreements, setting out service standards and benchmarks, were not in place.
- There was little evidence of systematic compliance training being conducted at all levels within mortgage operators.
- Poor compliance monitoring practices were identified at the compliance officer level as follows:
 - Breach registers not adequately being maintained
 - Compliance checks being conducted solely by walking around.
- Poor compliance reporting practices were identified at the compliance officer level as follows:
 - Only verbal reports provided to the compliance committee and Board
 - Reports did not cover all aspects of compliance (i.e. compliance with financial licence conditions generally omitted)
- Compliance monitoring at the Board or compliance committee level
 - No verification of information being undertaken
 - Evidence of a general lack of understanding as to contents of the compliance plan

In cases where these were the only issues identified, ASIC undertook an educative approach to address them by sending out letters of findings to the Board and management of the mortgage operator. The intention of this approach was to gain commitment from the Boards to address the issues through audits of compliance practices, modifications of operating procedures and in some cases changes to staffing.

4. THE POSITION IN TASMANIA

4.1 – The Industry in Tasmania

There were 32 solicitors mortgage schemes operating in Tasmania prior to the introduction of the Managed Investments Act 1998 with approximately \$600 million invested in them in total². Two schemes operated as pooled funds, the balance were contributory mortgage schemes.

² Information from Law Society in December 1998

The exemption for small Industry supervised schemes³ does not apply in Tasmania as the Law Society of Tasmania is not an approved industry supervisory body and did not seek to be approved as an industry supervisory body for this purpose.

The current situation with the funds is as follows:

1. two firms now operate with their own responsible entity;⁴
2. one firm has an arrangement with Perpetual Trustees Tasmania Limited to run its fund as responsible entity;⁵
3. 15 firms' funds are in the process of run out;
4. several firms have sold off their mortgage registers to Perpetual Trustees Tasmania Limited;⁶ and
5. several other firms have sold off their mortgage registers to La Trobe Capital and Mortgage Company Limited.⁷

The current financial status of the funds is as follows (statistics derived from the ASIC audit as at 31 March 2001):

1. funds still under management - approximately \$57.7 million / 1700 investors; and
2. loans in default - approximately \$23.3 million.

Post notice date events:

1. a default order has been made in respect of McCulloch and McCulloch mortgage fund. This order provides a return of capital (\$1 million - \$1.2 million); This would reduce the expected likely loss to investors figure by an equivalent amount,
2. Sale of properties by Worrall (\$30,000) and mortgagor repayment of \$43,000.

4.2 Recent ASIC Activities in Tasmania

Since November 1998, ASIC has received 21 individual complaints about solicitors mortgage funds in Tasmania. In most cases, the Law Society was already investigating the alleged conduct and ASIC thought it appropriate not to make any further inquiries until after the Law Society had completed their investigations. In circumstances where the complainants had not previously been in contact with the Law Society, those complaints were referred to the Law Society with the consent of the complainants. In

³ see 3.1 above

⁴ Butler McIntyre & Butler, Clerk Walker & Stops

⁵ Murdoch Clarke.

⁶ Including Piggott Wood & Baker, Dobson Mitchell & Allport, and Douglas & Collins.

⁷ Including Ware & Partners.

relation to complaints about Dessipur Pty. Ltd., a corporate borrower, from the Lewis Driscoll & Bull mortgage fund, an investigation was commenced in November 1999.

Since the commencement, in February 2001, of ASICs special enquiry into run out mortgage schemes, ASIC has been centrally processing and assessing complaints. ASIC has received nine complaints in relation to the conduct of run-out schemes in Tasmania.

In response to two of those complaints, ASIC has convinced the operator of the mortgage scheme to take action to contact the affected clients to ensure that they are not being misled in relation to the management of their mortgages.

One complaint was anonymous and did not specifically allege any misconduct in relation to the firm.

The other six complaints (all relating to one operator) are the subject of an investigation into that operator.

A significant proportion of ASICs enforcement resources in Tasmania have, in recent times, been employed in investigating matters relating to mortgage schemes. Examples of those activities include the following:

Garrisons: One national securities dealer group based in Tasmania (Garrisons) was noticeably active in advising clients to invest in solicitors mortgage funds. In particular, Garrisons' authorised representatives recommended clients invest with Piggott Wood & Baker, Lewis Driscoll & Bull and McCulloch & McCulloch. Approximately 70 investors in these schemes have been unable to liquidate their investment.

Last year, one of Garrisons' authorised representatives (Mark Hudson) was conditionally banned in relation to the recommendation of investment in solicitors mortgage funds. The delegate found that Hudson had breached section 851 and section 995 in relation to his dealings with the investors.

Dessipur Pty Ltd: ASIC successfully applied for the appointment of a liquidator to Dessipur Pty. Ltd., a borrower in the Lewis Driscoll and Bull mortgage fund, to preserve assets and protect the interest of the company's creditors.

Current Investigations: ASIC is currently undertaking three major investigations in relation to solicitors mortgage funds in Tasmania. The potential outcomes in these matters include criminal, civil penalty and civil proceedings.

Lewis Driscoll and Bull: ASIC has filed an interlocutory application to intervene in proceedings brought by the manager of the Lewis Driscoll and Bull mortgage fund to have the mortgages in the fund transferred to the investors. ASIC is concerned that the mortgages should not merely handed back to the investors to manage. The next return date is 2 July 2001.

Releases of Information: ASIC has received and responded to three FOI applications for documents in relation to the banning of Mark Hudson. ASIC has also received three applications for the release of the written record of the examination of Mark Hudson

pursuant to section 25 of the ASIC Law and has decided to release part on the transcript in respect of two applications.

ANNEXURE 1



ASIC

Australian Securities & Investments Commission

Mortgage Investment Schemes

ASIC policy proposal

October 1998

Your comments

We invite your comments on the *issues for consideration* in this paper.

Comments are due by **Friday 13 November 1998** and should be sent to:

Project Manager

Mortgage Investment Schemes Project

Regulatory Policy Branch

Australian Securities and Investments Commission

GPO Box 4866

SYDNEY NSW 1042

Facsimile: (02) 9911 2066

regpol.syd@asic.gov.au

You can also contact ASIC Infoline on 1300 300 630 for information and assistance or download the paper direct from ASIC home page:

<http://www.asic.gov.au>

Many mortgage investment schemes offered by solicitors and finance brokers are "managed investment schemes" under Chapter 5C of the Law. Since the commencement of Chapter 5C on 1 July 1998 managed investments are now regulated in a different way. In light of these changes and the recent problems associated with the mortgage investment industry, we are reviewing the most appropriate regulatory framework for mortgage investment schemes.

We invite public comment on the policy proposals set out in this paper about the way Chapter 5C and Part 7.12 of the Law should apply to mortgage investment schemes, and particularly to mortgage investment schemes operated by solicitors and finance brokers.

We seek information about the range of practices in the mortgage investment industry and what impact applying Chapter 5C and Part 7.12 will have on those practices. We also seek information on the impact of compliance with Chapter 5C on persons who are required to comply with law society or finance brokers institute rules. We are interested in proposals about how law societies or finance brokers institutes might continue to have a role in facilitating or supervising their members' compliance with Chapter 5C.

We will modify our policy proposals, when appropriate, to take into account comments received during the public consultation period. Details on how to send your comments to us are set out in this paper.

Purpose

This paper sets out our view on how mortgage investment schemes should be regulated (including those presently operated by solicitors and finance brokers under class order exemptions). We want information on whether there is any reason to vary or extend our general policy on managed investments in ASIC Policy Statements 130 to 136 because of the specific features of mortgage investment schemes and of the existing mortgage investment industry. We also want information from solicitors and finance brokers on whether the Law is inconsistent with Rules with which they must comply.

In this policy proposal we:

- (a) propose that persons operating mortgage investment schemes that are managed investment schemes must comply with Chapter 5C and our policies applying to managed investments generally;
- (b) identify those mortgage investment schemes which we consider fall within the definition of managed investment scheme;
- (c) identify the kinds of situations where we will consider using exemption and modification powers to depart from the approach identified in Policy Statements 130 to 135 in accordance with our general policy on exemptions and modifications in Policy Statement 136;
- (d) propose to enable the use of supplementary prospectuses to offer interests in mortgage investment schemes by modifying Division 2 of Part 7.12; and
- (e) indicate we will limit the operation of existing class orders and transitional class orders to mortgage investment schemes existing prior to 31 March 1999.

This paper deals only with mortgage investment schemes which fall within the definition of managed investment scheme. It does not deal with debentures offered by solicitors' mortgage investment companies.

This paper should be read in conjunction with ASIC Policy Statements 130 to 136 on implementing the Managed Investments Act 1998. Contact the ASIC Infoline on 1 300 300 630 for information and assistance.

Key terms

In this proposal paper a number of words and phrases are used in a special way:

“existing class orders” means class orders exempting members of a professional association from compliance with Divisions 2 and 5 of Part 7.12 and section 1078;

“investor” means a lender to a mortgage investment;

“manager” means a person who operates a mortgage practice or manages a mortgage investment scheme;

“managing a mortgage” includes receiving interest payments or principal from the borrower, monitoring compliance with the terms of the mortgage, or taking remedial steps in the event of borrower default;

“mortgage investment” means an investment where an investor or investors lend money to another person or persons with a mortgage over real property as security for the loan;

“mortgage investment scheme” means a mortgage investment which is a managed investment scheme (see further policy proposal No. 3);

“mortgage practice” means a business which promotes, arranges or manages mortgage investments;

“professional association” means any body whose members are authorised by statute to undertake conveyancing and includes the Queensland Law Society Inc., The Law Society of New South Wales, Law Institute Victoria, Law Society of Tasmania and The Finance Brokers Institute of South Australia Incorporated;

“transitional class orders” means class orders exempting members of a professional association from compliance with Chapter 5C;

“Rules” means the rules of a professional association.

References to statutory provisions are to those of the Corporations Law (Law).

Contents

PURPOSE.....	4
KEY TERMS.....	5
CONTENTS.....	6
OUR POLICY PROPOSAL — ISSUES FOR CONSIDERATION.....	7
Our approach to regulating mortgage investment schemes.....	7
Licensing of Managers.....	9
Disclosure.....	11
Transitional Issues.....	11
Regulatory and financial impact.....	12
EXPLANATION.....	13
Current regulatory regime.....	13
Managed Investments Regulatory Framework.....	14
Our approach to regulating mortgage investment schemes.....	14
Licensing of Managers.....	18
Disclosure.....	18
Transitional Issues.....	20
REGULATORY AND FINANCIAL IMPACT.....	21
DEVELOPMENT OF POLICY PROPOSAL.....	23
WHAT WILL HAPPEN NEXT?.....	24

Our policy proposal — issues for consideration

Policy proposal	Issues for consideration
<p>Our approach to regulating mortgage investment schemes</p> <p><i>Compliance with Chapter 5C</i></p> <p>1 Persons who operate mortgage investment schemes which are required to be registered must comply with Chapter 5C.</p> <p><i>Relief from Chapter 5C</i></p> <p>2 We will give relief from specific provisions of Chapter 5C in accordance with paragraphs 2 and 12 of ASIC Policy Statement 136:</p> <p>(a) if there are specific features of mortgage investment schemes which make strict compliance with Chapter 5C impossible or disproportionately burdensome;</p> <p>(b) to members of professional associations who are bound to comply with Rules if:</p> <p>(i) the Rules apply to the same activity as that regulated by and achieve the same regulatory outcomes as Chapter 5C; and</p> <p>(ii) compliance with both particular Rules and the Chapter 5C provision would be impossible or create an undue burden; or</p> <p>(c) to enable a professional association to have a role in ensuring their members comply with Chapter 5C;</p> <p>provided such exemptions do not reduce investor protection.</p>	<p>2A Are there any features of mortgage investment schemes which make strict compliance with Chapter 5C impossible or disproportionately burdensome?</p> <p>2B Are there any provisions in Chapter 5C which create practical difficulties for solicitors or finance brokers? For example, are there any inconsistencies between Rules and the Law, such as the requirement that the responsible entity be a public company, or that there be independent directors?</p> <p>2C What are the potential roles for a professional association? For example, could it act as the responsible entity for schemes conducted by its members? Should members be able to contract with a professional association for that association to provide services relating to the member's compliance obligations? Could the professional association provide the compliance audit?</p> <p>2D Is there any other basis for treating mortgage investment schemes offered by solicitors and</p>

Policy proposal	Issues for consideration
<p><i>What mortgage investments are managed investment schemes?</i></p> <p>3 A mortgage investment is a managed investment scheme if:</p> <p>(a) two or more investors contribute money to acquire interests in a mortgage, either:</p> <p>(i) directly and someone other than all of the investors collectively manages the mortgage; or</p> <p>(ii) through a nominee (“contributory mortgage”); or</p> <p>(b) a mortgage is held by a nominee for one investor (“solo mortgage”).</p>	<p>finance brokers differently from those offered by other persons?</p> <p>3A Are there other forms of mortgage investments which fall within the definition of a managed investment scheme?</p> <p>3B What practical difficulties might arise from this interpretation of the definition?</p>
<p><i>Registration of Schemes</i></p> <p>4 A mortgage investment scheme must be registered if there are more than 20 investors in the mortgage, or the manager is in the business of promoting mortgage investment schemes (section 601ED(1)).</p> <p>5 We will give relief from the requirement to register each mortgage investment scheme where:</p> <p>(a) an umbrella mortgage investment scheme is registered under Chapter 5C; and</p> <p>(b) the umbrella mortgage investment scheme’s</p>	<p>5A Are there any practical difficulties in registering an umbrella mortgage investment scheme?</p> <p>5B Are there any other matters that we should take into account when granting relief?</p>

Policy proposal	Issues for consideration
<p>constitution provides for sub-schemes and makes proper provision for accounting, scheme property and the like on a sub-scheme basis; and</p> <p>(c) the mortgage investment schemes operated by the manager are consistent with the umbrella mortgage investment scheme constitution, compliance plan and relevant licence conditions.</p>	
<p>Licensing of Managers</p>	
<p>6 A manager must apply for a licence authorising them to operate a managed investment scheme with mortgages as the underlying assets in accordance with Policy Statement 130.</p>	<p>6A Should this licence contain any specific conditions?</p> <p>6B Are there any sorts of mortgage investment schemes which should be distinguished as they require different competencies?</p> <p>6C Must a manager be a public company?</p>
<p>7 A manager will not be licensed to operate mortgage investment schemes involving development loans unless the manager can demonstrate they have relevant project management experience and are competent to manage loans of this kind.</p>	<p>7A What types of qualifications and competencies should a manager proposing to operate development loans have?</p> <p>7B What conditions should be imposed on licenses authorising development loans?</p>
<p>8 A development loan is a loan to fund the construction of a building on mortgaged property, which is to be drawn down before completion of the building.</p>	
<p><i>Financial Requirements</i></p>	
<p>9 Subsection 784(2A) sets out the financial</p>	<p>9A Are there any reasons why managers of</p>

Policy proposal	Issues for consideration
<p>requirements that a responsible entity must satisfy to have a licence authorising it to operate a managed investment scheme. The responsible entity must have net tangible assets to the value of:</p> <p>(a) \$50,000; or</p> <p>(b) where the value of scheme property is greater than \$10 million, 0.5% of the value of scheme property up to a maximum of \$5 million.</p>	<p>mortgage investment schemes should not have the same financial requirements as managers of other managed investment schemes?</p>
<p><i>Custody of Scheme Property</i></p> <p>10 A responsible entity will not be required to use a third party custodian where:</p> <p>(a) it has \$5 million or more in net tangible assets [ASIC Policy Statement 131.5]; or</p> <p>(b) it has \$500,000 or more in net tangible assets and all the assets of the scheme fall within the categories set out in paragraph (2) of ASIC Policy Statement 131.6.</p>	<p>10A Are there any other scheme assets, apart from the mortgage, debt and interest receipts, which constitute the scheme property?</p> <p>10B For custodians of scheme property for mortgage investment schemes, is there any reason to depart from the policy stated in ASIC Policy Statement 131.5-6?</p> <p>10C Should mortgages be added to the classes of assets not required to be held by a third party custodian as set out in ASIC Policy Statement 131.6? If so, why?</p> <p>10D Will third party custodians of scheme property of mortgage investment schemes have difficulty in complying with the standards for scheme property custodians set out in Policy Statement 133?</p>

Policy proposal	Issues for consideration
<p>Disclosure</p> <p><i>Division 2 of Part 7.12 - Prospectuses</i></p> <p>11 A person offering interests in a registered mortgage investment scheme (other than excluded offers) must prepare a prospectus. The prospectus must comply with Division 2 of Part 7.12 and the Corporations Regulations, or any successor provisions under the Corporate Law Economic Reform Program.</p> <p><i>Modifying Division 2 of Part 7.12</i></p> <p>12 We will modify Division 2 of Part 7.12 to permit:</p> <p>(a) a prospectus being registered which deals with the manager's mortgage practice, an umbrella mortgage investment scheme and the operation of mortgage investment schemes in general; and</p> <p>(b) supplementary prospectuses which deal with the particulars of each specific mortgage investment scheme. Each supplementary prospectus need only be given to the potential investors in the specific mortgage investment scheme and must be accompanied by the prospectus for the manager's mortgage practice scheme.</p>	<p>11A Are there any specific difficulties in preparing a prospectus for mortgage investment schemes? For example, are there difficulties created by the disclosure of personal information in a public document? Is there an appropriate alternative disclosure regime?</p> <p>12A Is a modification to allow the use of supplementary prospectuses for individual offers appropriate?</p> <p>12B Should there be any conditions imposed before the relief is granted?</p> <p>12C Should there be any restrictions on who should be able to have this relief?</p>
<p>Transitional Issues</p> <p>13 Our policy is to apply from 1 April 1999.</p>	<p>13A Will a start date of 1 April 1999 provide sufficient time for managers to comply with Chapter 5C or for applications for</p>

Policy proposal	Issues for consideration
<p>14 The existing class orders will be modified to apply only to the extent of allowing the manager to offer and issue interests to replace investors in mortgage investment schemes which existed at 30 June 1998 and to allow Division 2 relief for mortgage investment schemes established between 1 July 1998 and 31 March 1999, during the transitional period finishing on 30 June 2000.</p> <p>15 The transitional class orders will be modified to enable a manager to operate those individual mortgage investment schemes which came into existence between 1 July 1998 and 31 March 1999 without complying with Chapter 5C during the transitional period set out in Part 11.2 - Division 11 "Changes Resulting from the Managed Investments Act 1998" finishing on 30 June 2000.</p> <p>16 All persons who operate and offer interests in mortgage investment schemes which come into existence on or after 1 April 1999 must comply with Chapter 5C and Division 2 of Part 7.12.</p>	<p>exemptions and modifications to be made?</p> <p>14A Are there any other circumstances where - the existing class orders may need to apply?</p>
<p>Regulatory and financial impact</p> <p>17 We have considered the regulatory and financial impact of our policy proposals in this paper. We have sought to minimise the regulatory and financial impact of our policies on the operation of schemes without compromising the investor protection outcomes of the Law. More detailed analysis is contained in the section of this paper headed "Regulatory and financial impact".</p>	<p>17A To assist us to more accurately assess the regulatory and financial impact of the proposals in this paper, we want your comments on the questions raised at the end of the section of this paper headed "Regulatory and financial impact".</p>

Explanation

Current regulatory regime

1. Since May 1992, the Australian Securities and Investments Commission (formerly called the Australian Securities Commission (ASC)) has provided class order exemptions for pooled mortgage investment schemes operated by solicitors and finance brokers. These exemptions provide relief from Division 2 (prospectuses) and Division 5 (trust deed and trustee) of Part 7.12 and section 1078 (sharehawking) of the Law.

2. The "mischief" to which the Law was directed in the case of prescribed interest schemes was lack of accountability, lack of information and lack of prudential controls. Where these considerations were adequately dealt with by law societies, and where there were well established lending practices, the ASC considered the objects set out in subsection 1(2) of the ASC Law justified the granting of the exemption (see "Report of a Public Hearing on Solicitors' Mortgage Investment Schemes" [1992 ASC Digest at PH 112]).

3. Since the class order exemptions were given, there have been several failures of mortgage businesses throughout Australia, in some cases involving large amounts of money and large numbers of investors. The ASC commenced a review of the effectiveness of the regulatory regime applying to mortgage schemes governed by the class order arrangements and commissioned an independent analysis and report into the industry, received in September 1997. The report examined the structures and practices associated with the current relief from the Law and identified problems which needed to be addressed to better protect consumers and improve standards of practice in the industry.

4. Our analysis of the mortgage investment industry indicates that the involvement of professional associations has not necessarily been enough to ensure that schemes with the benefit of the exemptions are conducted in a satisfactory way. Our review concluded that the regulatory arrangements needed to address the following areas:

- Segregation of the assets of the mortgage practice from the rest of the manager's business;
- Secure and adequate accounts and record keeping systems;
- Monitoring compliance with the terms of the mortgage, Rules and class orders;
- Complaints handling procedures;
- Adequacy of insurance and fidelity fund arrangements;
- Competencies of the manager of the mortgage practice;

- Investment evaluation issues such as valuation practices and borrower credit analysis; and
- Use of general authorities and powers of attorney.

Managed Investments Regulatory Framework

5. Chapter 5C of the Law (inserted by the Managed Investments Act 1998) came into operation on 1 July 1998. Chapter 5C prescribes a new system of regulation for all managed investment schemes in Australia. The legislation fundamentally changes the nature of the regulation that was previously provided by Division 5 of Part 7.12.

6. Many mortgage investment schemes fall within the definition of “managed investment scheme” under the Law. In light of the change in the way managed investments are regulated and the problems associated with the mortgage investment industry, we are considering the most appropriate regulatory framework for mortgage investment schemes.

7. Chapter 5C relies on the scheme constitution and compliance arrangements rather than a division of responsibilities between the manager and trustee and prescribed covenants in the trust deed. It allows for more efficient and flexible structuring of schemes.

Our approach to regulating mortgage investment schemes

8. We have considered various options for regulating mortgage investments, including:

- (a) continuing the present position by providing class order exemptions from Chapter 5C for solicitors and finance brokers in a similar form to the existing class orders, but modified to address the problems areas identified in our review;
- (b) requiring all managers of mortgage investment schemes to comply with Chapter 5C subject to granting exemptions and modifications which would take into account specific features of mortgage investment schemes and of the mortgage investment industry; and
- (c) requiring full compliance with Chapter 5C and existing ASIC Policy.

Compliance with Chapter 5C

9. In our view, the option set out in paragraph 8(b) is the most appropriate regulatory approach. Significant industry failures, the problems identified in our analysis of the mortgage investment industry and the recent changes to the legislation

combine to make a change in the regulation of these schemes desirable. We consider that Chapter 5C adequately deals with the areas of concern identified by our review as set out in paragraph 4. It should also be easier for managers of mortgage investment schemes to comply with Chapter 5C than with the previous legislation.

10. We recognise that specific features of mortgage investment schemes may make complying with all aspects of Chapter 5C impossible or disproportionately burdensome. For instance, while investments in mortgage investment schemes are large in aggregate, each mortgage typically involves few investors, which may affect the ability to benefit from the economies of scale envisaged by Chapter 5C and the prospectus provisions. This may be a reason to modify the operation of Chapter 5C and Division 2 of Part 7.12 as they apply to mortgage investments. We also recognise that historically, mortgage investment schemes have been operated by solicitors and finance brokers, and that solicitors in particular, must comply with Rules applicable to mortgages.

11. Accordingly, we prefer the approach that Chapter 5C and our Policy Statements 130 to 136 on managed investment schemes apply to persons who operate mortgage investment schemes, subject to modifications:

- (a) when justified by specific features of mortgage investments;
- (b) when those provisions create practical difficulties for solicitors and finance brokers who must also comply with Rules in relation to the mortgages and those Rules apply to the same activity as that regulated by Chapter 5C; or
- (c) to give a professional association a role in making sure that their members comply with Chapter 5C

provided that the modification would not reduce investor protection.

Relief from Chapter 5C

Specific features of mortgage investment schemes

12. We are interested in receiving comments on whether there are any features of mortgage investment schemes which would make strict compliance with Chapter 5C impossible or unduly onerous. We will consider modifications to provisions of Chapter 5C in light of any such comments.

Chapter 5C and Rules

13. For historical reasons, most managers of mortgage investment schemes are solicitors or finance brokers who are members of professional associations. We recognise that these associations have Rules governing the operation of mortgage investment schemes. It may be that there is conflict between the provisions of Chapter 5C and the Rules, or that complying with both the Law and the Rules would create an undue burden without necessarily adding to the protection of investors.

14. We are interested in knowing how a professional association's Rules would apply to solicitors and finance brokers who operate mortgage investment schemes in compliance with Chapter 5C. If Rules do apply, to what extent is there overlap or inconsistency? We will consider modifying Chapter 5C when it is inconsistent with Rules which provide equivalent safeguards to the Law and when complying with the Law would be disproportionately burdensome.

Role for professional associations

15. We recognise that professional associations have played a major role in regulating mortgage investment schemes operated by their members. We are interested in identifying what role there may be in the future for a professional association whose members operate mortgage investment schemes complying with Chapter 5C.

16. We are interested in receiving propositions as to possible roles for a professional association in applying Chapter 5C to its members. For example, could a professional association act as a responsible entity for mortgage investment schemes conducted by its members? Would it be possible for members to contract some aspects of its obligations under Chapter 5C to a professional association? In considering whether to enable a professional association to maintain a role in regulating mortgage investments, we will assess whether or not investors would still have the level of protection that they were intended by Parliament to have under Chapter 5C. We will also assess what commercial benefit there would be for the parties to the scheme.

17. We are conscious that solicitors and finance brokers, supervised by relevant professional associations (law societies and institutes, and finance brokers institutes), play a significant role in the existing retail mortgage investment industry. We also recognise that there are a wide range of industry practices and that full compliance with Chapter 5C and the prospectus provisions may not be appropriate in all circumstances. We would also like to identify situations where full compliance with Chapter 5C may be inconsistent with law society or finance brokers institute rules.

What mortgage investments are managed investment schemes?

18. Section 9 defines a managed investment scheme to mean a scheme that has the following features:

- (i) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);
- (ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from contributors); and

(iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions).

19. Two types of mortgage investments may be managed investments: “solo mortgages” and “contributory mortgages”.

Contributory Mortgages

20. In a “contributory mortgage”, several investors contribute money to acquire interests in a mortgage. Any contributory mortgage in the name of a nominee falls within the definition of a managed investment scheme. A contributory mortgage in the name of the investors is a managed investment scheme, if it is managed by a third party or one investor on behalf of the other investors. This is because each investor’s contribution is used to acquire rights to benefits produced by the scheme (the interest on the loan and the security over the land) and the contributions are pooled to produce financial benefits and a right or interest in property (the mortgage). The investors do not have day-to-day control over the operation of the scheme. In both cases, either the solicitor or finance broker, or the manager of the contributory mortgage must be the responsible entity and comply with the provisions of Chapter 5C.

Solo mortgages

21. In a “solo mortgage”, there is only one lender. Where the lender is registered on the mortgage, this is not considered to be a managed investment scheme because the investor owns the asset, and there is no relevant “contribution” nor “scheme” under the definition. However, a mortgage held by a nominee for one investor would fall within the definition of managed investment scheme.

Mortgage practice

22. A mortgage practice which matches lenders and borrowers and prepares the necessary mortgage documents for a fee or commission is not a managed investment scheme. However, if the mortgages themselves are managed investment schemes, the matching amounts to a dealing in securities, and the manager is required to hold a dealers licence authorising them to carry on a securities business.

Registration of Schemes

23. A mortgage investment scheme must be registered if there are more than 20 investors in the mortgage, or the manager is in the business of promoting managed investment schemes.

24. Unless the manager arranges mortgage investment schemes only on a sporadic basis, we consider the manager is in the business of promoting mortgage investment schemes.

25. In the majority of cases, a manager will be required to register all mortgage investment schemes. We are proposing to grant relief from the requirement to register

each individual mortgage investment scheme where an umbrella mortgage investment scheme is registered which contemplates sub-schemes and makes proper provision for the operation of the sub-scheme mortgage investment schemes.

Licensing of Managers

26. In our view managers of mortgage investment schemes must meet minimum competency standards. Different types of mortgage investment schemes may require different qualifications and competencies.

27. We consider that managing a development or construction loan requiring monitoring of progress payments during building requires different skills from those required for managing mortgage investment schemes made on completed buildings. We are interested in receiving comments on what qualifications and competencies a manager must demonstrate to obtain a licence to operate mortgage investment schemes with development or construction loans.

Financial requirements

28. In Policy Statement 131, we indicate that we will exempt from the mandatory requirements of subsection 784(2A) only in exceptional circumstances. We seek comments on whether there is any reason to depart from the statutory financial requirements because of specific features of mortgage investment schemes or the mortgage investment industry.

Custody of scheme property

29. We recognise that in certain circumstances, it may be unreasonably costly for operators of schemes to retain a custodian which can meet the \$5 million financial resources requirement. We also recognise that custodial systems for some scheme property need not be as sophisticated as for other kinds of schemes. We are interested in receiving comments on whether there are specific features of mortgage investment schemes which indicate that a reduced amount of custodial financial resources could apply.

Disclosure

30. A person offering interests in mortgage investment schemes must still comply with the fundraising provisions of the Law even if they have an exemption from Chapter 5C. In particular, s1018 requires a registered prospectus, unless it is an excluded offer or invitation. Paragraph 66(3)(d) provides that an offer or invitation of interests in a registered scheme is excluded if there are less than 20 offers in 12 months. The effect of this is that where there are less than 20 offers of interests in a mortgage, no prospectus would be required. Many of the problems we identified in our review relate to

disclosure to investors and we are contemplating requiring persons offering mortgage investment schemes to comply with the prospectus provisions in Division 2 of Part 7.12. Accordingly, we propose to declare that each scheme offered by a manager is closely related to each other scheme offered by that manager. The effect of this will be that all such interests are of the same class and s66(3)(d) will not apply if interests in mortgages operated by one manager are offered to more than 20 investors in 12 months (see s66(4)(c)). Accordingly, a prospectus will be required.

31. Section 1022 as modified by reg. 7.12.12 provides that an issuer of a prospectus under must undertake such inquiries as it would be reasonable for the issuer to make to enable an investor to make an informed assessment of the risks of participating in the scheme. Compliance with s1022 requires disclosure about the manager offering the mortgage investment, investments in mortgages in general, and also disclosure about the particular mortgage being offered. For mortgage investment schemes does this mean disclosing the personal details and creditworthiness of the prospective borrowers?

Modifying Division 2 of Part 7.12

32. We have indicated that we are prepared to grant relief from registration for individual mortgage investment schemes where an umbrella mortgage investment scheme is registered. The exemption from registration of the individual mortgage investment schemes does not remove the requirement to issue a prospectus for each scheme.

33. An interest in managed investment scheme is a security under section 92(2) regardless of whether the scheme is registered. Section 1018 requires a prospectus for an offer or invitation to subscribe for such securities unless it is an excluded offer or invitation. Paragraph 66(3)(da) provides that an offer or invitation is excluded if it relates to interests in a managed investment scheme which is not registered under section 601EB and is not required to be registered under section 601ED.

34. It may not be cost effective to require a registered prospectus for every mortgage investment, regardless of the number of investors or the amount of the funds to be borrowed.

35. Therefore, we are prepared to modify the Law to enable a manager to register a generic prospectus in relation to an umbrella mortgage investment scheme and to allow offers of interests in an individual mortgage investment scheme to be made through that generic prospectus and a supplementary prospectus setting out the details required by s1022 in relation to the particular mortgage.

36. We are interested in comments on the extent to which personal information about a borrower is provided. As the use of a supplementary prospectus is likely to result in personal details of the borrower being available to the public on the ASCOT database system, is there some alternative disclosure regime which would be suitable?

Transitional Issues

37. The policy resulting from this paper is to apply from 1 April 1999. The practical effect of this is that all mortgage investment schemes offered or entered into after that date must comply with Chapter 5C and the prospectus provisions in Division 2.

Existing class orders

38. Division 5 of Part 7.12 focused on offers of prescribed interests. The focus in Chapter 5C is on operating managed investments. The transitional provisions of the Managed Investments Act 1998 allow prescribed interest schemes existing at 30 June 1998 to be operated without complying with Chapter 5C during the two year transitional period. We propose that all mortgage investment schemes entered into before Chapter 5C commenced should have the full benefit of the transitional provisions.

39. Because existing mortgage investment schemes have a limited number of investors and are for a finite period, we anticipate that exemptions from Divisions 2 and 5 of Part 7.12 will be necessary only when a manager needs to replace an existing investor in a mortgage. The new investor could be introduced by the sale of the existing interest or by the issue of a new interest. If there was no exemption from Division 5, a trust deed would be necessary to enable this to occur. If there was no exemption from Division 2, a prospectus would be required for the offer of the new interest. (The secondary trading provisions apply to the sale of an existing interest).

42. Therefore, we propose to leave the existing class orders in place, to the extent necessary to enable replacement of investors in existing mortgage investments. We are interested in receiving comments on whether there are any other situations in which the existing relief is necessary to enable existing mortgage investment schemes to have the full benefit of the transitional period.

Transitional Class Orders

43. We propose that individual mortgage investment schemes entered into during the period of the transitional class orders, that is 1 July 1998 to 31 March 1999, continue to operate during the transitional period without having to comply with Chapter 5C. Division 2 relief under the existing class orders will also apply to enable the replacement of existing investors without the need for a prospectus.

Regulatory and financial impact

1. We have considered the regulatory and financial impact of our policy proposals in this paper. In making this consideration we have:

- (a) excluded any overall assessment of the levels of any regulatory and financial impact of direct costs or burdens arising from requirements or obligations under the Act;
- (b) focused only on those policy options and proposals in this paper when the Law requires us to exercise a discretion;
- (c) taken into account the regulatory outcomes contemplated in the Act regarding the protection of the interests of investors; and
- (d) sought to minimise the regulatory and financial impact and costs of operating a mortgage investment scheme.

2. In general, we are of the view that the policy proposals in this paper have been preferred after consideration of any relevant options as discussed in the section of this paper headed "Explanation".

3. We have considered the regulatory and financial impact of our policy proposals in this paper.

4. In general, we are of the view that the policy proposals in this paper will have no greater regulatory and financial impact on the burden and cost of operating a mortgage investment scheme than that which results from the implementation of the Managed Investments Act. Transition costs will be incurred in moving to the new regulatory arrangements. Solicitors and finance brokers presently operating under existing class orders will also incur ongoing compliance costs. However, the proposed new regulatory arrangements will result in greater investor protection and will reduce the burden and costs on professional associations.

We seek comments on the following questions

5. For the purposes of enabling us to more accurately assess the regulatory and financial impact of the policy proposals in this paper, we seek comments by affected persons on the likely costs and benefits of:

- (a) requiring a mortgage investment scheme to comply with Chapter 5C;
- (b) a manager who is a member of a professional association operating a mortgage investment scheme being required to comply with both Chapter 5C and the Rules of the professional association;
- (c) a professional association playing a role in members' compliance with Chapter 5C;

- (d) requiring individual mortgages to be registered;
- (e) providing for the registration of an umbrella mortgage investment scheme;
- (f) requiring the manager of a mortgage investment scheme to hold a dealers licence authorising them to operate managed investment schemes;
- (g) requiring a manager who matches lenders and borrowers but does not operate mortgage investment schemes to hold a dealers licence authorising them to carry on a securities business;
- (h) requiring additional competencies for development loans;
- (i) requiring a third party custodian of scheme property of mortgage investment schemes;
- (j) requiring a prospectus for offers of interests in mortgage investment schemes;
and
- (k) implementing the proposed policy on 1 April 1999.

Development of policy proposal

We have developed this policy proposal paper taking into account:

- the intention of the Managed Investments Bill as indicated in the Explanatory Memorandum to the Bill and the Second Reading Speech in the House of Representatives on the introduction to the Bill into Federal Parliament;
- relevant comparisons with previous legislative requirements for the regulation of prescribed interest schemes under the Law;
- our policies on regulating managed investment schemes under the Law;
- historical information relevant to the ASC granting class order exemptions from the Law to solicitors and finance brokers offering mortgage investments (particularly the ASC Public Hearing on Solicitors' Mortgage Investment Schemes in March 1992);
- a report commissioned by the ASC to examine the structures and practices associated with the class order relief and to identify key problem areas which needed to be addressed;
- the failure of some mortgage businesses in various States;
- preliminary discussions with small groups of key affected persons or associations whose primary function was to assist us as a "sounding board" to ideas and provide comment on particular issues and draft proposals. They do not have responsibility for the content of these proposals and may not agree with them;
- the experience we have with the existing class order regime for mortgage investments.

What will happen next?

Stage 1

13 October 1998

ASIC paper released

Stage 2

October 1998

Meetings with key groups of affected persons to consider the paper

13 November 1998

Comments due on the paper

November 1998

Drafting of Policy Statement

Stage 3

December 1998

Policy Statement released

Your comments

We invite your comments on the *issues for consideration* in this paper.

Comments are due by **Friday 13 November 1998** and should be sent to:

Project Manager
Mortgage Investment Schemes Project
Regulatory Policy Branch
Australian Securities and Investments Commission
GPO Box 4866
SYDNEY NSW 1042
Facsimile: (02) 9911 2066
regpol.syd@asic.gov.au

You can also contact ASIC Infoline on 1300 300 630 for information and assistance or download the paper direct from ASIC home page:
<http://www.ASIC.gov.au>

ANNEXURE 2



ASIC

Australian Securities &
Investments Commission

CONSUMER PROTECTION IN MORTGAGE SCHEME INVESTMENTS

Delivering adequate and effective consumer protection for investors in mortgage investment schemes while allowing operators some flexibility is the focus of policy proposals issued by the Australian Securities and Investments Commission (ASIC) today.

ASIC's proposal aims to ensure that investors in mortgage schemes continue to be properly protected.

In an information release issued today ASIC sets out its preliminary position on the future regulation of mortgage investment schemes.

The proposals have been developed following a detailed review, including public and industry consultation.

ASIC is calling for comments on this proposal and these will form the basis of a formal policy statement scheduled to be released in early May 1999.

ASIC believes that compliance with the newly introduced legislative framework provided for by the Managed Investments Act 1998 should be the starting point for the future regulation of mortgage investment schemes.

ASIC accepts however that mortgage investment schemes require some relief to enable operators to continue to offer the investment choice afforded by these products.

Under the proposals ASIC will offer relief from the Corporations Law to two types of mortgage investment schemes.

Large scale schemes will obtain only limited relief from the law. These include:

- a) development loans,
- b) where the sum secured by the mortgage is more than 80% of the unencumbered value of the mortgaged property;
- c) interstate offers or invitations; and
- d) public advertising; and
- e) schemes with more than 40 investors or loans which total more than \$5 million..

ASIC Chairman Alan Cameron said this will put them on a more equal regulatory footing with Corporations Law regulated mortgage trusts.

"This recognises that investors in public offer schemes, schemes susceptible to known regulatory risks and larger scale schemes should have the safe guards of the managed investment and fundraising provisions of the Corporations Law."

.../2

MEDIA RELEASE

The limited relief ASIC is considering includes modifying the corporations law to allow the use of two part prospectuses. This recognises the particular structure of these schemes, where investors hold interests in identified mortgages rather than in a pool of mortgages.

Smaller schemes would get more substantial relief where ASIC is satisfied that a supervisory regime provided by an industry body (for example some professional associations of lawyers) provides an adequate alternative way of delivering the investor safe guards provided by compliance with the Corporations Law..

The proposal also includes exempting schemes from having to register under the Corporations Law, from being a public company and from holding a Corporations Law licence. We are also considering a modified disclosure regime.

ASIC welcomes comments on the policy positions outlined in the information release by 9 April 1999.

For further information contact:

Irene O'Brien

ASIC Media Unit

Tel: (02) 9911 2097

ASIC 99/035

ANNEXURE 3



ASIC

Australian Securities &
Investments Commission

MORTGAGE INVESTMENT SCHEMES - PRELIMINARY POLICY POSITION

1. INTRODUCTION

This information release sets out ASIC's preliminary position on the future regulation of mortgage investment schemes. It has been prepared after a detailed review of mortgage investment schemes, including extensive public and industry consultation.

ASIC welcomes comments on the general approach taken in this release which is intended to form the basis for a formal policy to be released in early May 1999. ASIC's present intention is to require compliance with the new regime from early October 1999. ASIC is now also seeking comment on any issues these proposed transitional arrangements may raise.

In the interim class order relief already granted will continue to apply, subject of course to full compliance with the conditions applying to that relief.

ASIC has sought to develop a policy position which permits appropriate investment choices whilst ensuring adequate and effective consumer protection.

On 1 July 1998 the Managed Investments Act became law. That Act introduced a new regime for the regulation of the managed investments industry. The Act was the final stage of a process of extensive inquiry into the regulation of the managed fund industry which arose out of a number of large scale failures in the industry in the late 1980s. Accordingly, ASIC believes that consumer protection considerations mean that compliance with the newly introduced Commonwealth legislative regime should be the starting point for the future regulation of mortgage investment schemes.

However, no legislative regime can be appropriate for all circumstances. The legislative framework allows ASIC to adapt the regime by giving relief from, or by modifying, the provisions of the statutory regime where such an approach is justified. ASIC accepts that mortgage investment schemes require some relief and will use its exemption and modification powers to enable operators to continue to offer the investment choice afforded by these products. ASIC will offer tailored relief for the two categories of schemes described below.

2 TWO CATEGORIES PROPOSED

ASIC proposes that future regulation of mortgage investment schemes be built around two categories: .../2

INFORMATION

Category 1: schemes that will be subject to a lightly modified Chapter 5C regime.

Category 2: some smaller schemes that will be substantially exempt from Chapter 5C because the industry supervision they are subject to is an adequate alternative to compliance with most of Chapter 5C.

-3

CLARIFICATION OF OTHER MATTERS

In addition, ASIC will provide information and relief needed to clarify the limits of the application of Chapter 5C to the smallest schemes. This is because the limits of the definition of “managed investment” are sometimes unclear in the context of mortgage schemes. This is further discussed at paragraph 6.

4

CATEGORY 1: SCHEMES SUBJECT TO A LIGHTLY MODIFIED CHAPTER 5C

4.1 INTRODUCTION

Schemes in this category will be regulated as far as possible by Chapter 5C and the fundraising provisions. Modifications (or conditional exemptions) will be available to adapt the regime to the particular features of mortgage investment schemes and to eliminate legal uncertainties, but otherwise Chapter 5C will apply.

4.2 DEFINING THE CATEGORY: TYPES OF SCHEMES

In Category 1 are public offer schemes, schemes susceptible to known regulatory risks, and larger scale schemes. These schemes are schemes involving **any one** of the following characteristics:

- (a) development loans;
- (b) loans where the sum secured by the mortgage (at the time of entry into the mortgage) is more than 80% of the unencumbered value of the mortgaged property;
- (c) interstate offers or invitations (except local offers, in border regions);
- (d) public advertising;
- (e) investors do not choose the mortgage(s) in which their funds are invested;
- (f) an operator who manages, or whose associates manage, schemes involving:
 - (i) a total of more than 40 investors; or
 - (ii) loans the total amount of which is more than 5 million dollars;
- (g) smaller scale schemes that do not fit within Category 2.

[Note: The numerical limits in paragraph (f) are for illustrative purposes only. They are preliminary and ASIC will be further examining them. Comment and suggestions are particularly sought on these limits and their relation with analogous numerical limits in the Corporations Law.]

4.3 WHAT RELIEF WILL BE PROVIDED

(A) Relief from Chapter 5C

The modifications and conditional exemptions for this class of schemes will:

- eliminate legal uncertainties by permitting the registration of a “practice-wide” scheme (rather than treating each mortgage as constituting a separate scheme). Investors in each mortgage under the umbrella registration arrangement will constitute a different class under the umbrella scheme;
- allow a licensed scheme operator to hold scheme property in the form of title documents, mortgages, declarations of trust and cash held in a prudentially regulated institution, without having to meet the Corporations Law requirements for additional net tangible assets (NTA). The relief replaces the normal requirement that, to hold scheme property, an operator must either have NTA of at least \$5 million or the assets must be held by a separate custodian;
- allow the use of an “umbrella” mortgage-practice prospectus with mandated supplementary information being provided for each mortgage;
- allow mortgage practice expertise to be taken into account in assessing applications for dealers licences applicable to these schemes;
- require that scheme cash be held in a trust account that is regularly audited.

Otherwise, Chapter 5C will apply in full, including the requirement that a scheme operator must be a public company, that schemes must be registered, and the requirements relating to scheme constitutions, compliance plans and so on.

(B) Relief from Prospectus Provisions:

ASIC does not consider that it is appropriate to exempt schemes totally from the prospectus provisions. However, it will give relief to allow the use of a two-part prospectus:

- a standard form part which describes the main features of mortgage lending and the rights of a lender and answers certain questions about the investment (this part will be lodged with ASIC); and
- a supplement which is specific to the mortgage in question, and must include details of the security, valuation, prior securities, loan to valuation ratio, interest, duration and other terms and the credit of the borrower. ASIC accepts that there is a sound public policy argument for keeping private details of the borrower, the property and the terms of the transaction off the public register and is exploring ways this can be done without lessening the protections available to investors through the supplementary prospectuses provisions.

5 CATEGORY 2: SCHEMES SUBSTANTIALLY EXEMPTED FROM CHAPTER

5.1 Introduction

More substantial relief from the obligations will be available to smaller scale schemes where ASIC is

.../4

satisfied that the supervisory regime provided by an industry body (for example some professional associations of lawyers) provides an adequate alternative way of delivering the protections provided by compliance with Chapter 5C. In this context “smaller scale” means a scheme that has none of the characteristics listed in paragraph 4.2(a) to (f).

ASIC believes that this approach is appropriate for these comparatively small-scale schemes because:

- the cost of full compliance with the Chapter 5C requirements is likely to be disproportionately large for individual scheme operators;
- the supervisory framework provided by an industry body can result in a form of collectivised compliance in which:
 - the body’s rules can be an adequate substitute for the constitutional components required by Chapter 5C; and
 - the supervisory framework provided by the body and the firm’s auditors can be an adequate substitute for the compliance arrangements required by Chapter 5C.

Before granting relief, ASIC would have to be satisfied of the adequacy of the rules and supervisory arrangements of the industry body. Criteria for this have yet to be finalised, but will probably be based on a combination of best practice and the existing law body regimes.

5.2 DEFINITION

Industry supervision regimes might include those administered by:

- (A) existing State-based bodies though their capabilities, including rules and supervisory regimes, will need review and adaptation;
- (B) other bodies not at present involved in supervising mortgage practices, including bodies set up by promoters of mortgage schemes to carry out industry supervision on a cooperative basis.

5.3 WHAT RELIEF WILL BE PROVIDED

(A) General

The relief would include relief from the obligations to:

- register schemes under Chapter 5C;
- be a public company;
- hold a Corporations Law licence.

(B) Disclosure

At this stage, ASIC is inclined to require schemes in Category 2 to comply with the modified disclosure regime that applies to schemes in Category 1. The cost-benefit arguments that provide the rationale for substantially exempting Category 2 schemes from compliance with Chapter 5C do not, in ASIC’s view, hold good for the disclosure obligations of the scheme operator.

5.4 CONTINUING CONDITIONS FOR PROVISION OF RELIEF

The main conditions will require the scheme operator to:

- comply continuously with the relevant rules of the body of which the scheme operator is a member;
- have a contract with its auditor that requires the auditor to notify ASIC of any breach of the rules relating to the conduct of mortgage schemes or a condition of the instrument of relief; and
- provide notification of individual mortgages to the supervising body.

Conditions will also ensure that relief of this kind is kept to the strictly limited category described above. Where necessary ASIC will use its powers under s601ED(3) of the Law to ensure that a number of schemes effectively operated by one person or by a group of associates are not treated as separate smaller scale schemes (see ASIC PS 136.82).

6 GUIDANCE AND RELIEF FOR THE REMOVAL OF LEGAL UNCERTAINTY

The Managed Investments Act for the most part deals with broad principles rather than specific circumstances or individual cases, and the scope of the legislative definition of managed investment schemes will in some cases be unclear. ASIC therefore expects that it will need to provide specific guidance in relation to types of activity and schemes.

In responding to ASIC's public consultation paper, a number of legal practitioners have requested ASIC to provide guidance on whether specified activities amount to operating a managed investment scheme - for example, whether a lawyer taking remedial action for a mortgagee client is carrying on a scheme. The Policy Statement that ASIC is developing will indicate ASIC's position on recurring issues of this general kind. Class Order relief may be needed in some cases to firm up the boundaries and ensure that the law is being appropriately applied in a range of circumstances.

For further information contact:

Malcolm Rodgers
ASIC Director Regulatory Policy
Tel: (02) 9911 2680
Job (0411) 549 011

Julie Abramson
ASIC Principal Lawyer
(03) 9280 3237

ASIC Information Release 99/012

ANNEXURE 4

[PS 144] Mortgage investment schemes

Chapter 5C — Managed investment schemes
Part 7.12 — Offering securities for subscription or purchase

Issued 2/3/2000

What this policy statement is about

[PS 144.1] This policy statement sets out how we will regulate mortgage investment schemes. It describes:

A our general policy on regulating mortgage schemes that are managed investment schemes;

see [PS 144.3]–[PS 144.6]

B which mortgage schemes are regulated as managed investment schemes;

see [PS 144.7]–[PS 144.16]

C what relief we will give for all regulated schemes;

see [PS 144.17]–[PS 144.32]

D what extra relief we will give for small industry supervised schemes;

see [PS 144.33]–[PS 144.46]

E when and how we will implement our policy.

see [PS 144.47]–[PS 144.68]

[PS 144.2] We are publishing this policy as a final policy statement however we may make some minor adjustments to our policy as a result of the Corporate Law Economic Reform Program Act 1999 (“CLERP Act”).

Contents

What this policy statement is about ... [PS 144.1]

A Our general policy ... [PS 144.3]

B Which mortgage investments are managed investment schemes ... [PS 144.7]

C General position — a lightly modified regime ... [PS 44.17]

D Small industry supervised schemes ... [PS 144.33]

E Implementing our policy ... [PS 144.47]

A Our general policy

[PS 144.3] Our policy when regulating mortgage investment schemes is that:

(a) if you operate a mortgage scheme that is a managed investment scheme you must

- comply with Ch 5C of the Corporations Law;
- (b) in most respects, we apply the policies we have adopted for other managed investment schemes to mortgage scheme operators but in some areas we provide relief specific to mortgage scheme operators;
 - (c) we have eliminated one source of legal uncertainty by making the business of providing mortgage investment services the focus of our regulation, not individual mortgages;
 - (d) if you are the operator of a small industry supervised scheme we will allow you to comply with an approved industry body's rules rather than all of Ch 5C. We allow this if the industry body can supervise such schemes effectively and if appropriate insurance arrangements are in place;
 - (e) although we require prospectuses for all regulated mortgage investment schemes, we allow the use of a two-part prospectus, so that private details about a borrower can be kept off the public register. This relief will continue after the prospectus provisions in Ch 6D introduced by the CLERP Act commence on 13 March 2000.

Explanation

[PS 144.4] Our policy is designed to permit appropriate investment choices while ensuring adequate and effective consumer protection.

[PS 144.5] On 1 July 1998 a new regime for regulating the managed investments industry was introduced when the Managed Investments Act became law. The Act resulted from an extensive inquiry into regulating the managed funds industry which arose out of a number of large scale failures in the industry in the late 1980s. In our view, consumer protection considerations mean that compliance with this regime should be the starting point for regulating mortgage investment schemes.

[PS 144.6] In general, mortgage investments that are subject to the provisions of the Law should be regulated in the same way as other managed investment schemes. Our general policies applying to managed investment schemes will apply. We accept, however, that mortgage investment schemes require some specific relief, which we will provide under our exemption and modification powers.

B Which mortgage investments are managed investment schemes

Our interpretation

[PS 144.7] Whether the managed investments legislation applies to you depends on how you carry on your mortgage business. If you are in doubt you will need to seek your own legal advice.

[PS 144.8] Our approach to how the definition of managed investment scheme applies to mortgage investment services has two elements:

- (a) the nature and extent of your *activities* as a provider of mortgage investment services is critical to deciding whether you operate a managed investment scheme that needs to be registered under the Law; and
- (b) our policy that the focus of regulation should be on the *service provider* rather

than the individual mortgage.

Explanation and guidance

Focus on activities

[PS 144.9] We encourage you to focus on the nature and extent of the *activities* undertaken as a provider of mortgage investment services in deciding whether a mortgage investment scheme needs to be registered under Ch 5C of the Corporations Law. You will need to view these activities as a whole and in their full commercial context. You will need to especially concentrate on the question of who makes, in practice, the important commercial decisions.

[PS 144.10] The following key factors are relevant to whether Ch 5C applies to a scheme:

- (a) the extent to which the legal or commercial character of the investment depends on the business or operations of the promoter. For example:
 - (i) if discrete interests in contributory mortgages are pooled and money contributed by different investors is lent under one mortgage. This strongly indicates the characteristics of a managed investment scheme (unless the money is jointly managed or invested for reasons other than investment in the mortgage scheme);
 - (ii) if mortgages are taken in the name of a nominee for one investor. This is less clear-cut, but may indicate the characteristics of a managed investment scheme, if it is done to facilitate management or transfer the investor's interest;
 - (iii) if the availability of borrowers, securities or particular terms depends on the scale and continuity of your business. This may also indicate the characteristics of a managed investment scheme;
- (b) the extent to which commercial decisions are taken by the operator or the promoter of the scheme, and not by investors. This must be a matter of fact and degree in each case. But it seems to us that the most important factor is who takes the commercial decisions, and not, for example, who acts as a postbox or draws up documents to implement decisions, once made. For example:
 - (i) if you routinely make investment decisions under general authority, or decide whether to extend loans or enforce securities, without referring decisions to investors. This strongly indicates the characteristics of a managed investment scheme (contributory mortgages are generally managed in this way, but not all nominee mortgages are);
 - (ii) if you are responsible for obtaining, or determining valuations and approving lending against those valuations, or administering a repayment system. This suggests a managed investment scheme;
 - (iii) conversely, if a solicitor documents a security and settles an advance under the instructions of a person who makes their own bargain. This does not give the transaction the characteristics of a managed investment scheme;
- (c) whether the scheme attracts s601ED, as discussed at [PS 144.11]--[PS 144.16].

Focus on service provider

[PS 144.11] There are different legal views about how the definition of a managed investment scheme applies to mortgage investment schemes:

- (a) On one view, every mortgage in a mortgage investment practice may be a separate scheme.
- (b) On another view, the practice itself may be a scheme instead of, or even as well as, each mortgage.

[PS 144.12] In view of this uncertainty, we want to make sure that the law is sensibly and pragmatically applied. We will use our discretion to achieve an outcome consistent with the intended purpose of the legislation. This means that if your mortgage investment services amount to a managed investment scheme you will not have to register each mortgage arrangement as a separate scheme. We will allow you to register a single scheme covering multiple mortgage services if you can show that you can meet all your obligations as a responsible entity by doing so.

[PS 144.13] We will also use this same practical approach to resolve what may otherwise be problems with applying s601ED of the Corporations Law. That section provides that a managed investment scheme must be registered if it:

- (a) has more than 20 members; or
- (b) was promoted by a person...who was, when the scheme was promoted, in the business of promoting managed investment schemes.

[PS 144.14] Section 601ED may mean that if you provide mortgage services to 20 or fewer people you will not be regulated by Ch 5C if there is only one mortgage, but may be regulated if there are number of mortgages. This is because each mortgage might be a separate scheme and the you might be regarded as being in the business of promoting managed investment schemes. We will exempt you from the obligation to comply with Ch 5C and the prospectus provisions of the Law unless the total number of all the investors in schemes you manage is more than 20. We will exempt you because we consider:

- (a) the focus of regulating mortgage investment schemes should be on the provision of services; and
- (b) for the purposes of s601ED, we should not regard a person as being in the business of promoting mortgage investment schemes unless the total number of investors in all schemes is more than 20.

[PS 144.15] The number of investors is to be calculated in accordance with s601ED(4). This may be particularly important where a trustee has invested in the scheme.

[PS 144.16] This relief is not available if you are an associate (eg an agent) of the operator of a registered mortgage investment scheme (see Class Order [CO 99/1639]).

C General position — a lightly modified regime for registered schemes

Our policy

[PS 144.17] We will regulate mortgage investment schemes as far as possible by Ch 5C and the fundraising provisions of the Corporations Law. We will modify (or give

conditional exemptions from) the Law to:

- (a) adapt the regime to the particular features of mortgage investment schemes; and
- (b) eliminate legal uncertainties.

Apart from these modifications Ch 5C and the fundraising provisions will apply.

[PS 144.18] This means that:

- (a) a scheme operator must be a public company and be licensed as a responsible entity; and
- (b) schemes must be registered, and must comply with the requirements about scheme constitutions, compliance plans and so on.

See our general policies in Policy Statements 130 to 136.

[PS 144.19] This approach will apply to all schemes other than those discussed in Section D and those exempted under our other policies.

Relief from Chapter 5C and section 1022

Chapter 5C

[PS 144.20] We will modify the way Ch 5C applies by allowing you to register a single scheme covering any number of mortgages, rather than treating each mortgage as a separate scheme that must be separately registered.

[PS 144.21] Normally if you hold scheme property we require you to have net tangible assets (NTA) of at least \$5 million. However, we have given relief to certain mortgage schemes so that you do not have to meet this requirement in some cases. Our policy on NTA for a person holding scheme property is given in Policy Statement 131 *Managed Investments: Financial requirements* [PS 131]. In a number of cases, you (or a third party custodian) need only meet the NTA requirement set out in s784(2A).

Our relief applies to scheme assets that are:

- (a) mortgages or documents of title held under a mortgage when certain conditions are met; or
- (b) cash held for up to 3 months in an audited trust account while an application for a mortgage is processed. This cash would include the incidental fees and costs of acquiring a mortgage.

You should refer to Class Order [CO 99/558] and your licence conditions for further details.

[PS 144.22] To obtain this relief, operators of mortgage schemes involving general authorities must (unless the investor holds the mortgage and documents of title):

- (a) tell the investor about the property chosen for them and give them an opportunity to approve your choice; or alternatively
- (b) allow the investor a 14 day "cooling off" period when they may withdraw from the mortgage.

[PS 144.23] Even if you cannot meet these requirements you may still qualify to hold scheme property. You may qualify if:

- (a) you have a minimum NTA of \$500,000; and
- (b) all assets of the scheme that are not assets described in [PS 144.21] are either:
 - (i) mortgages over real property to be held for the duration of those mortgages; or

- (ii) cash and deposits held in a regulated trust account for up to six months pending its initial investment.

If a mortgage scheme involves other types of assets, our normal policy on NTA will apply, see Policy Statement 131 *Managed Investments: Financial requirements* [PS 131].

Two stage prospectuses

[PS 144.24] We will give relief to allow the use of a two stage prospectus. The first part must contain information about the services provided by the operator of the mortgage investment scheme, and the second part details about the individual mortgage transaction. This relief is contained in Class Order [CO 99/1638].

[PS 144.25] Such a prospectus must, as a whole, comply with s1022 and reg 7.12.12 (and, after, the CLERP Act commences, s710 of the Law). It can be made up of two parts, each of which must be given to an investor:

- (a) a generic part (see [PS 144.26]); and
- (b) a specific part (see [PS 144.27]).

[PS 144.26] The generic part will not need to be changed for different mortgages, and it must be lodged with us. It should set out:

- (a) the main features of mortgage lending under the operator's scheme;
- (b) the relationship between the operator and investors;
- (c) the rights of a lender;
- (d) the fees and charges that will apply;
- (e) the valuation practices the operator will use;
- (f) the loan to valuation ratio policy the operator will use;
- (g) indicative rates of return;
- (h) procedures in place to address risks associated with speciality loans (including the process used to assess the capacity of the borrower to meet repayments);
- (i) a description of the types of loans that make up the scheme; and
- (j) any other matters listed in Class Order [CO 99/1638].

[PS 144.27] The specific part is specific to the mortgage in question. It does not need to be lodged with us, but you must keep a copy of it. This part of the prospectus must say that it is to be read with the generic part. It should contain details about:

- (a) the borrower offering the mortgage, including their creditworthiness;
- (b) the mortgage itself and the rights that go with it;
- (c) the property that is to be mortgaged, how it has been valued and what is its value;
- (d) the loan to valuation ratio;
- (e) any prior securities the property is subject to;
- (f) the interest the borrower will pay;
- (g) how long the loan will last; and
- (h) the arrangements for repaying it.

Explanations

Chapter 5C

[PS 144.28] The relief from Ch 5C described in [PS 144.20] gives effect to our general approach to regulating mortgage schemes. The relief permitting you to register a single

scheme makes providing mortgage services the focus of regulation, rather than individual mortgages: see Section B at [PS 144.11] onwards.

[PS 144.29] Our approach to the NTA requirements for those who hold the assets most commonly involved in mortgage schemes is an extension of our general policy. This is that the NTA requirements that normally apply can be relaxed. They can be relaxed when this is justified by the nature of the property normally involved in a type of scheme.

Two stage prospectuses

[PS 144.30] We are conscious that investors benefit from shorter, comprehensible, disclosure documents, and we are encouraging the use of simple, concise prospectuses in other areas. Our policy of requiring mortgage scheme prospectuses to comply with the disclosure standard in s1022 (and after the CLERP Act commences, s710) is not intended to result in long or complicated documents. We anticipate that for most mortgage investment schemes operators will be able to comply with their disclosure obligations in a way that is helpful to investors and cost effective for them. This is because most schemes are relatively standard and straightforward.

[PS 144.31] In our view, the fundraising provisions of the Corporations Law should apply to offers of interests in mortgage investment schemes. However, we accept that there is a sound public policy argument for keeping private details of the borrower, the property and the terms of the transaction off the public register. We will give relief to allow this, but at the same time we will maintain the protections available to investors through a novel use of the supplementary prospectuses provisions. This is achieved by relief to allow only the generic part of the prospectus to be lodged, mentioned in [PS 144.26].

[PS 144.32] Not all schemes will need this two-part prospectus. For example, a mortgage scheme in which you make all the decisions about which mortgages are to be acquired may be structured so that the specific part of the prospectus is not necessary. In such a case, it is likely that you can meet all your obligations by issuing a single prospectus that complies with s1022 of the Corporations Law (or s710 of the Law after the CLERP Act commences).

D Small industry supervised, schemes

Our policy

[PS 144.33] We are prepared to give more substantial relief from Ch 5C of the Corporations Law for some small scale schemes. We will give this relief if we are satisfied that:

- (a) the schemes are adequately supervised by an industry body (for example some professional associations of lawyers); and
- (b) the regime administered by the industry body provides an adequate alternative way of delivering the protections provided by direct compliance with Ch 5C.

[PS 144.34] Before we grant relief of this kind, we must be satisfied that the rules and supervisory arrangements of an industry body are adequate. We will work with interested industry bodies to develop criteria for approving arrangements of this kind.

[PS 144.35] We will not grant this kind of relief to public offer schemes, schemes

susceptible to known regulatory risks, and larger scale schemes. Schemes are not eligible for relief based on participation in an industry based compliance regime if they have any one of the following characteristics:

- (a) development loans;
- (b) loans where the sum secured by the mortgage (at the time of entry into the mortgage) is more than 80% of the unencumbered present day value of the mortgaged property;
- (c) interests in the scheme are offered interstate (except for local offers in border areas);
- (d) public advertising;
- (e) investors do not choose the mortgage(s) in which their funds are invested; or
- (f) an operator who manages, or whose associates manage, schemes involving loans the total amount of which in aggregate is more than 7.5 million dollars.

What relief will be provided

Full relief from Chapter 5C

[PS 144.36] If you operate a small scheme described in [PS 144.33], you do not have to comply with the managed investment and licensing requirements of the Law. This is because we have issued a class order which exempts you from those provisions of the Law and Ch 5C will not require you to:

- (a) be a public company;
- (b) hold a responsible entity licence; or
- (c) register your mortgage scheme.

[PS 144.37] Prior to the CLERP Act, the prospectus and sharehawking provisions of the Law will still apply to operators of small schemes. The prospectus provisions have important consequences if you conduct your mortgage practice through a proprietary company. We cannot grant relief from s113(3) of the Law under which a proprietary company cannot do anything that would mean it has to lodge a prospectus.

You will be able to lodge a prospectus in your individual name under s92(4) of the Law before the CLERP Act commences.

When the CLERP Act commences on 13 March 2000, interests in unregistered managed investment schemes will no longer be securities for the purposes of the prospectus provisions (see s92(3)(c) of the post CLERP Law). Therefore, neither the prospectus provisions nor s113 will apply to offers of interests in schemes we exempt from registration under Ch 5C.

Limited disclosure relief

[PS 144.38] We will provide the same, limited relief to small schemes as we provide to other mortgage investment schemes (see Section B). As a result of the change introduced by the CLERP Act (referred to in [PS 144.37]) we will impose a condition that schemes we exempt from registration provide disclosure to the same standard as schemes under modified Ch 5C regulation. This will be a condition of relief from Ch 5C and not from the prospectus provisions. Therefore the schemes will not attract s113.

What conditions will apply

[PS 144.39] The conditions of our relief will require you to:

- (a) comply continuously with the relevant rules of the body of which the scheme operator is a member;
- (b) have a contract with your auditor that requires the auditor to notify ASIC of any breach of the rules on the conduct of mortgage schemes;
- (c) notify individual mortgages to the supervising body immediately after the mortgage agreement is made;
- (d) hold scheme cash in a separate and designated trust account that is regularly audited; and
- (e) have in place insurance arrangements that will give investors the same level of protection as if the scheme was regulated under Ch 5C.

[PS 144.40] When necessary we will use our powers under s601ED(3) of the Law to ensure that a number of schemes effectively operated by one person or by a group of associates are not treated as separate small scale schemes (see Policy Statement 136 *Managed Investments: Discretionary powers and closely related schemes* at [PS 136.82]).

Explanations

[PS 144.41] Before 17 December 1999 regulation of mortgage investment schemes in most states relied primarily on state-based supervision, often involving the law societies. We no longer consider these arrangements appropriate for most mortgage investment schemes. However, we have decided that the option of industry body supervision should continue to be available in limited circumstances.

[PS 144.42] We believe that this approach is appropriate for these small scale schemes because:

- (a) the cost of fully complying with the Ch 5C requirements for operators of small schemes is likely to be disproportionately large, if the risks faced by investors in these schemes are relatively small;
- (b) the supervisory framework provided by an industry body can result in a form of alternative compliance regime to the managed investment provisions in Ch 5C of the Law when:
 - (i) the body's rules can be an adequate substitute for the constitutional components required by Ch 5C; and
 - (ii) the supervisory framework provided by the body and the firm's auditors can be adequate substitutes for the compliance arrangements required by Ch 5C.

What industry based bodies might apply for registration?

[PS 144.43] Industry supervision might include regimes administered by:

- (a) existing state-based bodies. However, their capabilities, rules and supervisory regimes will need reviewing and adapting;
- (b) other bodies not at present involved in supervising mortgage practices. These could include bodies set up by promoters of mortgage schemes to supervise the industry on a cooperative basis.

Criteria for approving industry bodies' supervisory role

[PS 144.44] Traditionally, professional bodies, such as law societies, have supervised mortgage practices. Law societies' supervisory powers and relationships with their members are generally supported by state legislation, as well as detailed rules of practice and conduct. We do not intend to limit our approval of industry based compliance regimes to law bodies, but the lack of statutory backing for alternate regimes raises a number of issues for us to consider.

[PS 144.45] We will set criteria that recognised industry supervisory bodies (ISB) must meet. We will consult with bodies that want to be considered as ISBs when we are formulating these criteria. The types of matters that we need to address include:

- (a) details about the ISB itself, including:
 - (i) the number of members and its coverage of the industry whether regionally, at state level or nationally;
 - (ii) the number, qualifications and experience of the staff who would supervise;
 - (iii) its financial and administrative resources to adequately and appropriately supervise;
 - (iv) what previous experience, if any, it has in supervising its members;
 - (v) how the ISB proposes to monitor and assess its own performance as a supervisor;
- (b) rules covering:
 - (i) the minimum standards of competence a member of the ISB must have before it can provide mortgage investment services;
 - (ii) financial requirements for members who operate schemes;
 - (iii) the capacity of members to operate mortgage scheme businesses;
 - (iv) due diligence in appointing and supervising agents;
 - (v) how books and records for mortgage schemes must be kept;
 - (vi) how often, and how, mortgage scheme books and records are to be audited;
 - (vii) how, and how often, scheme assets and the properties that are, or may be, the subject of mortgages are to be valued; competency standards for eligibility; specific prudential requirements and desired standards of conduct: appropriate financial accountability and audit practices; and rules on valuations;
 - (viii) how disputes between members and their mortgage scheme clients will be resolved; and
 - (ix) insurance requirements, see [PS 144.39] para (e);
- (c) particularly if the ISB does not operate under a statutory regime, what powers the ISB will have to compel members to adhere to certain standards, financial accountability and other matters, and to discipline for breaches of its rules;
- (d) how the ISB plans to carry out its supervisory role, including:
 - (i) how often its staff will make routine supervisory visits;
 - (ii) what staff will examine and assess on those visits;
 - (iii) how the ISB will identify and deal with emerging problems either with individual operators or more generally;
 - (iv) how the ISB will deal with complaints about its members; and
 - (v) what processes the ISB will have for disciplining members who breach its

- rules or the Law;
- (e) how the ISB will tell ASIC about compliance and enforcement issues; and
 - (f) whether there may be barriers that would prevent the ISB passing information about compliance and disciplinary matters to ASIC (such as other legislation or contractual arrangements between the ISB and its members), and if so the details of those barriers.

[PS 144.46] At 1 January 2000 the Law Institute of Victoria and the Law Society of New South Wales have asked to be considered as ISBs.

E Implementing our policy

Our policy

[PS 144.47] We recognise that there are a number of complex issues we must work through before all parts of our policy can be fully implemented. These issues include:

- (a) the interrelationship between the Corporations Law regime we administer and relevant state legislation, especially that applying to the legal profession;
- (b) the need for further detailed consultation with industry bodies who may want to be approved as industry supervisory bodies; and
- (c) what approach should we take to existing schemes.

The implementation regime set out below is designed to ensure that these issues are dealt with in a structured and commercially realistic way, but at the same time allow early implementation of the main elements of our policy.

Implementation — different approach for different types of schemes

[PS 144.48] Our timetable for implementing our policy depends on the type of scheme involved. For this purpose, there are three main types of schemes:

- (a) Schemes that are not eligible for relief as small industry supervised schemes (see Section D) and are not “run out schemes” (see [PS 144.51]).

See [PS 144.49]

- (b) Schemes that are eligible for relief as small industry supervised schemes as described in Section D.

See [PS 144.50]

- (c) “Run out” schemes

See [PS 144.51]–[PS 144.57]

Schemes that are not eligible for relief as small industry supervised schemes (see Section D) and are not “run out schemes” (see [PS 144.51])

[PS 144.49] Schemes of this type must comply with the new regime by 17 December 1999. At that time existing class orders will cease to apply to these schemes.

Schemes that are eligible for relief as smaller industry supervised

schemes (see Section D)

[PS 144.50] Relief from the managed investment provisions will continue to apply for each scheme of this type until 1 November 2001, if:

(a) the scheme is supervised by a body named in an existing class order;

and

(b) before 1 November 1999, that body has asked us to approve it as an industry based supervisor as described in Section C;

and

(c) before 1 March 2000 the operator of the scheme gives us an audit certificate (see Class Order [CO 99/1639]). This audit timetable may be adjusted by agreement with us.

“Run out” schemes

[PS 144.51] You may decide not comply with the Managed Investments Act or participate in an industry supervision arrangement. If you decide to do this then you must make satisfactory arrangements for bringing your scheme to an end and you must ensure appropriate supervision until it ends. In the meantime, you must not create new interests nor extend the duration of existing interests. We will apply our general policy to such schemes (see Policy Statement 135 *Managed investments: transitional issues* [PS 135] about schemes under approved deeds).

[PS 144.52] We will extend run out relief if you “split your practice” between schemes comprising:

(a) mortgages all made before 17 December 1999 which are in run out; and

(b) new mortgages made, or existing mortgages extended after 17 December 1999, which must be regulated by Ch 5C (unless otherwise allowed by the terms of paragraph 5(c) of Class Order [CO 99/1639]).

[PS 144.53] You may use run out relief while waiting to qualify for small industry supervised scheme relief or while reducing the number of scheme members to no more than 20. After the scheme has qualified for this other relief you will no longer need to meet the conditions of run out.

Time period for run out schemes

[PS 144.54] Run out schemes must conclude by November 2001. We may however need to vary this in particular cases if a state practice is to write mortgages for more than a two year term.

Supervision of run out schemes

[PS 144.55] We will treat a scheme as a run out scheme only if it is subject to an existing supervisory regime and that regime will stay in place for the life of the scheme. To ensure this, we will modify existing class orders so that they continue to apply through the run out period, if a law society or other professional body is prepared to undertake a continuing supervisory role. At 1 January 2000 this has occurred in Tasmania, Queensland, Victoria, New South Wales and South Australia.

[PS 144.56] An operator can only get run out relief if they give us an audit certificate before 1 March 2000 (see Class Order [CO 99/1639]).

Substituting investors

[PS 144.57] The class order will allow substitution of investors in existing schemes — that is, transferring existing interests to new investors. A new investor must be given the information that they reasonably need when deciding to enter the scheme. Because it would be unduly onerous to require a fresh valuation etc, the information may be given as at the date the mortgage was entered into. However, the information should include a statement about whether the operator has later information which is material to a decision to invest in that mortgage or scheme.

What this means for you

- [PS 144.58] From 17 December 1999 you cannot operate a mortgage scheme unless:
- (a) you comply with the Law, or the Law as modified in the way described in Section C of this policy (see [PS 144.17] onwards); or
 - (b) your scheme is a small industry supervised scheme as described in this policy statement *and* it is currently supervised by either the Law Institute of Victoria or the Law Society of New South Wales; or
 - (c) your scheme meets and qualifies for “run out” or closed scheme relief and the scheme will terminate before 1 November 2001; or
 - (d) your scheme has no more than 20 members.

How do I apply for registration

[PS 144.59] In general, you must register your scheme, unless it is a one-off promotion with no more than 20 members; all the interests are issued by excluded issue; or you have been given relief by us from the need to register your scheme. To register, you must meet the following three requirements of the Corporations Law:

- (a) the operator must be a public company;
- (b) the operator must be licensed; and
- (c) the scheme must be registered.

In addition, for registered schemes, a prospectus must generally be issued.

Operator

[PS 144.60] You must be a public company and licensed to operate the managed investment scheme as a responsible entity (certain minimum capital and insurance requirements apply — see [PS 131]).

Registered scheme

[PS 144.61] The scheme must be registered, which means that there must be:

- (a) a constitution and compliance plan which meet the requirements of the Corporations Law;
- (b) an auditor appointed to review compliance with, and the adequacy of, the scheme's compliance plan;
- (c) either at least half of the operator's board must be composed of external members or the operator must appoint a compliance committee, the majority of which is composed of external members. (The board or compliance committee must

- monitor compliance with the scheme's compliance plan); and
- (d) at least annual audited financial statements for the scheme lodged with us and provided to members of the scheme.

See our Policy Statements 130 to 134 on managed investments, and Form 701 [LIC 5] and Licensing Kit [LIC 1].

Transfer of existing interests

[PS 144.62] Any transfer of an existing interest from an existing mortgage scheme into a registered managed investment scheme may amount to an offer to subscribe for interests in that managed investment scheme. It may therefore require a prospectus. Any prospectus should meet the general disclosure requirements set out in the Law and may need to address issues affecting investors including:

- (a) possible stamp duty liability;
- (b) possible capital gains tax liability; and
- (c) potential loss of access to law society or other fidelity funds.

Licensing of intermediaries

To operate registered schemes

[PS 144.63] To register a scheme you must obtain a dealers licence under the Law which authorises you to operate a managed investment scheme.

Dealing in interests in registered schemes

[PS 144.64] To be able to deal in interests in registered managed investment schemes, you must hold a securities dealers licence.

Advising on registered schemes

[PS 144.65] To be able to give investment advice on interests in registered managed investment schemes, you must hold a securities dealers licence or an investment advisers licence.

An investment advisers licence will apply only in limited circumstances and you should consult Policy Statement 116 *Investment advisory services: licensing and "independent" advisory services* [PS 116].

If you advise clients to agree to the transfer of existing mortgages into a registered scheme you may be giving "investment advice".

After 1 July 2000 if you want to give investment advice under your dealer's licence you must meet further requirements. You should consult Policy Statement 130 *Managed investments: Licensing* at [PS 130.6] for further guidance on these matters.

There are also further important obligations below you should be aware of even if you will be participating in a small scale industry supervised regime or run out relief.

Interests in excluded schemes (schemes which do not have to be registered)

[PS 144.66] An operator does not have to hold a licence to operate a scheme or deal in

interests in a scheme if:

- (a) a mortgage investment scheme is not required to be registered, under an exemption; or
- (b) all issues under the scheme are excluded issues: see reg 7.3.11(1).

In particular, an operator does not have to hold a licence if the scheme operates under:

- (a) our former class order relief; or
- (c) our former class order relief as continued for transitional and run-out purposes; or
- (d) relief given under Section D of this policy statement: see [PS 144.34] onwards.

[PS 144.67] If you make recommendations about investments in an excluded mortgage scheme, although you do not have to operate under an appropriate licence, you have obligations under the Law to:

- (a) disclose any interest you have in the recommendation (you must do this under s849 of the Law); and
- (b) have a reasonable basis for the recommendation (under s851).

You have these obligations because under reg 7.3.11(1), s849 and s851 still apply to such activities.

[PS 144.68] There are also some other circumstances when you will generally not need to operate under a licence:

- (a) you are merely undertaking administrative activities by distributing a prospectus; or
- (b) you are referring someone to a licensee or their authorised representative. You are merely introducing a potential investor to a licensee and this is incidental to your other business.

For more information see our Policy Statement 121 *Investment advisory services: Mere referrals and other excluded activities* [PS 121].

Key terms

[PS 144.69] In this policy statement, a reference to: “audit certificate” means a certificate that:

- (a) is signed by:
 - (i) a registered company auditor;
 - (ii) an “approved auditor” under the Legal Profession Practice Act 1996 of Victoria;
 - (iii) a “trust account inspector” or an “investigator” under the Legal Profession Practice Act 1987 of New South Wales; or
 - (iv) an employee of the relevant industry supervisory body who is approved for the purpose by ASIC; and
- (b) states that the person who signs the certificate:
 - (i) has within the last 6 months reviewed the compliance arrangements of schemes conducted by the operator and any related schemes;
 - (ii) has within the last 6 months reviewed the loan books of the schemes. The certificate must state the total value of the loans managed under each of the schemes;
 - (iii) has been informed by the operators of the schemes whether each of the schemes is operating as a registered managed investment scheme or under

- an exemption. For each of the schemes, the certificate must specify the relevant exemption or state that the scheme is registered; and
- (iv) in the light of that review, has no reason to believe that the operators of the schemes have not complied, or will not comply with, the conditions of the relevant exemption or exemptions;

“CLERP Act” means the Corporate Law Economic Reform Program Act 1999.

“commencement” of the “CLERP Act” means 13 March 2000.

Related information

[PS 144.70]

Class orders and pro formas

Class Order [CO 99/558]

Class Order [CO 99/1638]

Class Order [CO 99/1639]

Policy statements and practice notes

Policy Statement 116 *Investment advisory services: licencing and “independent” advisory services*

Policy Statement 121 *Investment advisory services: Mere referrals and other excluded activities*

Policy Statement 130 *Licensing*

Policy Statement 131 *Managed Investments: Financial Requirements*

Policy Statement 135 *Managed Investments: Transitional issues*

ANNEXURE 5

[PS 130]

Managed investments: Licensing

Chapter 5C Part 5C.2 — Managed investment schemes

Issued 3/8/1998

Updated 4/11/1998, 2/6/1999, 4/10/1999

What this policy statement is about

In order to gain a full understanding of our policy in this area you should read all the parts of this policy statement, including the Underlying Principles and the Explanations.

[PS 130.1] This policy statement gives guidance on the requirements for obtaining and keeping a dealers licence authorising a responsible entity to operate a managed investment scheme or schemes. In particular, it provides guidance to applicants on:

A how to apply for a licence;

see [PS 130.3]–[PS 130.10]

B when a person needs a licence to carry on a securities business;

see [PS 130.11]–[PS 130.20]

C how ASIC categorises kinds of schemes;

see [PS 130.21]–[PS 130.31]

D capacity and expertise; and

see [PS 130.32]–[PS 130.63]

E procedures for complaints resolution.

see [PS 130.64]–[PS 130.66]

[PS 130.2] You must also satisfy the financial requirements set out in Policy Statement 131 *Managed investments: Financial requirements* [PS 131].

Contents

What this policy statement is about ... [PS 130.1]

A Applying for a licence

Our policy ... [PS 130.3]

Underlying principles ... [PS 130.5]

Explanations ... [PS 130.6]

B Licence to carry on a securities business

Our policy ... [PS 130.11]

Underlying principles ... [PS 130.14]

Explanations ... [PS 130.15]

C Kind of managed investment scheme

Our policy ... [PS 130.21]

	Underlying principles ... [PS 130.24]
	Explanations ... [PS 130.25]
D Capacity and expertise	
	Our policy ... [PS 130.32]
	Underlying principles ... [PS 130.39]
	Explanations ... [PS 130.40]
E Complaints resolution	
	Our policy ... [PS 130.64]
	Underlying principles ... [PS 130.65]
	Explanations ... [PS 130.66]
	Key terms ... [PS 130.67]
	Related information ... [PS 130.68]

A Applying for a licence

Our policy

[PS 130.3] If you are a public company, you can apply for a dealers licence (a "licence") to operate a managed investment scheme. This can be done before or at the same time that you lodge your application for scheme registration. However, we will not be in a position to consider scheme applications until licensing issues have been addressed. You should consider this timing issue when preparing and lodging scheme registration documents. If at the end of the statutory period for considering registration the licence has not been granted, we will be unable to register the scheme.

[PS 130.4] If you satisfy all the licensing requirements, we will send you a letter of offer of a licence. The offer is valid for four months and contains a number of pre-conditions for acceptance. Subject to meeting those pre-conditions, the licence will then be formally granted when your scheme is about to be registered.

[PS 130.4A] The standard conditions which will normally appear on a licence authorising a person to operate a managed investment scheme or a kind of managed investment scheme are contained in Pro Forma [PF 189]

[Historical note: PS 130.4A inserted 2/6/1999.]

How to obtain a licence application form

Obtain a Licensing Kit containing the application form from:

- Infoline on 1300 300 630; or
- ASIC's web site at www.asic.gov.au.

You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.

Copies of the Licensing Kit and Licence Application Form are reproduced in the *ASIC Digest* at [LIC 1] and [LIC 5].

Underlying principles

[PS 130.5] The Law requires that a responsible entity must be licensed by ASIC. In assessing whether or not to issue a licence, we will take into account an applicant's good fame and character, expertise and ability to perform the duties associated with being a responsible entity. We can assess this before a scheme is registered. However, in most cases, we will need to assess the scheme documentation before we can be satisfied that the pre-conditions for the issue of a licence have been actually met.

Explanations

Pre 1 July 1998 licensees

[PS 130.6] If you already hold a licence to manage a prescribed interest scheme, you can continue to operate the existing scheme that has an approved deed, for two years after 1 July 1998.

[PS 130.7] If you want to register a new scheme or an existing scheme you must have your licence varied, authorising you to operate the managed investment scheme. Although we will take into account your previous experience in operating schemes, you will have to complete the same application form as new applicants. Generally, we will authorise you to operate the kinds of schemes you currently operate: see [PS 130.28].

New applicants

[PS 130.8] Your suitability is easier to assess if you are operational when you apply. However, we recognise that it would be impractical to insist that all applicants be fully operational at that time. While we are prepared to issue an offer of a licence subject to pre-conditions in these circumstances, you will need to demonstrate your capacity to operate a scheme before we finally give you a licence: see [PS 130.42].

Letter of offer

[PS 130.9] When you have demonstrated that you are able to meet all the requirements, we will send a letter of offer containing pre-conditions that the licence will be varied or issued subject to you:

- (a) agreeing to the proposed licence conditions;
- (b) certifying that nothing material has altered in the information you provided in the licence application;
- (c) confirming that the appropriate staff, accounting, computer and operating systems, contractual arrangements and compliance standards referred to in your licence application are in place;
- (d) complying with the appropriate financial conditions (see Policy Statement 131 *Managed investments: Financial requirements* [PS 131]); and
- (e) lodging an application for scheme registration.

[PS 130.10] A letter of offer is valid for four months. If you want to extend this period, you can discuss it with us.

B Licence to carry on a securities business

Our policy

[PS 130.11] When we authorise you to operate a scheme, we will also authorise you to carry on a securities business in relation to the operation of that scheme. This authorisation allows you to carry out all activities necessary to operate the scheme.

[PS 130.12] If your licence application indicates that you want to provide investment advice in relation to interests in schemes operated by you, your licence will allow you to give that advice until 1 July 2000. If you want to give advice after 1 July 2000 on interests in schemes you operate, you will need to meet further education and experience qualifications. The qualifications you will need to meet are those required for licensees who give investment advice generally that apply at the time you are licensed.

[PS 130.13] If you want to deal and advise in securities other than your own scheme securities, you will have to meet our criteria for licensed persons giving investment advice when you apply for the licence.

Underlying principles

[PS 130.14] To ensure that investors receive advice from appropriately qualified persons, similar requirements should apply to all persons dealing in, or advising on, managed investments. If you give investment advice, you must comply with our requirements and those of the Law for a person giving such investment advice.

Explanations

Giving advice on your own securities

[PS 130.15] If you give investment advice on your own securities, you will need to comply with the Law, for instance, s849 and 851, and the Regulations about giving investment advice.

[PS 130.16] Currently, we do not require applicants who want to advise on their own securities to meet the educational criteria which we apply to retail investment advisers. However, we will impose a licence condition which will have the effect that if the licensee wishes to give investment advice on its own interests after 1 July 2000, it will have to meet the education and experience qualifications applying to licensees giving investment advice.

Dealing in or advising on other securities

[PS 130.17] If you propose to carry on a separate securities business, you must satisfy our criteria for persons carrying on such a business. Many of the criteria for obtaining a licence to operate a scheme are the same as those for carrying on a securities business. However, there are a number of differences, for example, education and experience of key staff.

[PS 130.18] You will also have to satisfy, concurrently:

- (a) the financial conditions imposed on responsible entities operating managed investment schemes; and
- (b) the financial conditions that apply to licensees carrying on a securities business.

When does a superannuation trustee require a licence?

[PS 130.19] A trustee approved to operate a regulated 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 (Cth) does not have to hold a dealers licence authorising it to operate managed investment schemes for those funds or trusts. This is because these schemes are specifically excluded from the definition of "managed investment scheme": s9.

[PS 130.20] However, an approved trustee conducting a business of providing investment advice on its own scheme interests may still be carrying on a securities business and require a licence (or alternatively it may use the services of a licensed dealer) because such interests are securities for the purposes of Parts 7.3 to 7.6: s92(1)(ca). (See Policy Statement 123 *Investment advisory services: Superannuation advice* [PS 123] for more details.)

C Kind of managed investment scheme

Our policy

[PS 130.21] Your licence will authorise you to operate either:

- (a) a specific scheme named on the licence; or
- (b) a scheme or schemes of a particular kind, according to the type of asset. You can be authorised to operate more than one kind of scheme.

[PS 130.22] If you can demonstrate that you have the capacity to operate a particular kind or kinds of scheme and you meet our other requirements, we will issue you with a licence authorising you to operate that kind or those kinds of scheme. This will mean that you do not have to seek an amendment to your licence each time you want to register a scheme of that kind.

[*Historical note:* PS 130.22 amended 2/6/1999 by inserting the last sentence: "This will mean that you do not have to seek an amendment to your licence each time you want to register a scheme of that kind."]

[PS 130.23] The following are the "kinds" of schemes which entities will be authorised to operate:

- (a) *Financial assets* This category includes cash; fixed interest securities; equities and related securities and interests in managed investment schemes (including where the managed investment scheme invests in direct real property);

[*Historical note:* PS 130.23(a) amended 2/6/1999 by replacing the words "and property security" with "(including where the managed investment scheme invests in direct real property)".]

- (b) *Derivatives* This category must be nominated if you use derivatives for hedging or any other purpose;
- (c) *Mortgages;*
- (d) *Member discretionary master funds and similar schemes* These are schemes where the assets that the member's rights will depend on are selected by the investor;
- (e) *Direct real property* These schemes are further categorised according to the type

of asset;

[*Historical note:* PS 130.23(e) amended 2/6/1999 by replacing the words "will be" with "are" and the word "scheme" with "asset".]

- (f) *Primary production* These schemes are further categorised according to the type of asset eg horticulture, aquaculture, commercial horse breeding;

[*Historical note:* PS 130.23(f) amended 2/6/1999 by replacing the words "will be" with "are" and the word "scheme" with "asset".]

- (g) *Film schemes*; and

- (h) *Time-sharing schemes*.

Protection of underlying land in primary production schemes

[PS 130.23A] As an interim policy, where an offer of interests in a primary production managed investment scheme is made with, or includes, an offer of rights regarding the land on which the scheme will occur, a special licence condition will be imposed in the dealers licence issued to the responsible entity (see [PF 189] for the standard conditions which will normally appear on a licence). The licence condition will ensure that,

- (a) an interest protecting the rights of members in relation to the land on which the primary production occurs is registered under applicable land titles, law and
- (b) the interest is registered as such that it cannot be adversely affected by either prior or later interests of others in the land.

[*Historical note:* PS 130.23A inserted 2/6/1999.]

Your comments

We invite your comments on the interim policy set out in [PS 130.23A] (elaborated on at [PS 130.31A] and [PS 130.31B]). An issues paper titled "Primary production schemes — Protection of underlying land in Primary Production Managed Investment Schemes" setting out a number of questions upon which ASIC seeks comment can be obtained from ASIC Infoline on 1300 300 630.

Comments are due by Monday 19 July 1999 and should be sent to:

Darren McShane
 Director
 Managed Investments, NSW
 Australian Securities & Investments Commission
 GPO Box 9827
 Sydney NSW 1042
 Facsimile (02) 9911 2369
 darren.mcshane@asic.gov.au

You can also contact Graham Plath on (02) 6250 3832 for further information about this interim policy.

Underlying principles

[PS 130.24] The nature of the scheme or kind of scheme will to a large extent determine the skills, expertise and capacity required by a person to perform the duties associated with a responsible entity. In establishing our approach to “kinds” of scheme, we have sought to balance the need for responsible entities to be able to demonstrate the appropriate capacity for the activity required with the flexibility of enabling new schemes to be added without requiring an amendment to the licence every time.

Explanations

[PS 130.25] There are different ways of categorising a “kind” of scheme. We consider that, generally, the type of assets managed is the most relevant attribute. We will therefore issue a licence which will authorise you to operate either:

- (a) a specific scheme eg ABC Property Trust No 1; or
- (b) a “kind” of scheme or schemes based on the type of assets managed or dealt with, eg financial assets, film schemes, serviced strata schemes or horticultural schemes.

[Historical note: PS 130.25 amended 2/6/1999 by replacing the words “category to adopt” with “attribute” and by inserting the words “serviced strata schemes or horticultural schemes” in para (b).]

[PS 130.26] When applying for a licence you will be asked to nominate the schemes, or kinds of scheme you intend to operate. If you have adequate accounting, computer, compliance and operating systems, and responsible officers or agents with the educational qualifications and experience appropriate to this kind of scheme, your licence will authorise you to operate the kinds of schemes (as listed in [PS 130.23]) that you nominate. You can nominate more than one kind of scheme.

[Historical note: PS 130.26 amended 2/6/1999 by replacing the words “scheme, or the kind or kinds of schemes” with the words “schemes, or kinds of scheme”, by replacing “these kinds of schemes” with “this kind of scheme” and by inserting the sentence: “You can nominate more than one kind of scheme.”]

Schemes using a range of assets

[PS 130.27] If you intend to operate schemes that invest in a range of asset kinds, your licence will have to cover all those assets. To obtain such a licence, you will need responsible officers, either internally or externally, who meet our education and experience criteria in relation to all the assets and financial instruments the schemes will be dealing in.

Pre 1 July 1998 licensees

[PS 130.28] If you already operate a prescribed interest scheme under a dealers licence and you want to operate a managed investment scheme or schemes, you will need to apply for a licence variation. You must state the kind of schemes you intend operating. If you meet our requirements for operating this kind of scheme, we will offer you a licence to operate the kind. If you meet our relevant requirements, you may be offered a licence for more than one type of kind.

[Historical note: PS 130.28 amended 2/6/1999 by replacing the words “those kinds” with the words “the kind” wherever occurring and by inserting the sentence “schemes or kinds of scheme”, by replacing “these kinds of schemes” with “this kind of scheme” and by inserting the sentence: “If you meet our relevant

requirements, you may be offered a licence for more than one type of kind.”]

New applicants

[PS 130.29] If you do not already operate a prescribed interest scheme, the licence issued to you will authorise you only to operate the first named scheme that you register. If you later want to operate other schemes, you must apply for a licence variation.

[PS 130.30] If the second or subsequent scheme is of the same kind as the first, we will generally vary your licence to authorise you to operate schemes of that kind if you satisfy the requirements set out in [PS 130.26].

[PS 130.31] There may be some instances when we will authorise a first time applicant to operate a kind or kinds of schemes. In such cases, the applicants will have to demonstrate the capacity, expertise and financial resources at a level equivalent to experienced licensees.

Protection for underlying land in primary production managed investment schemes

[PS 130.31A] In many primary production managed investment schemes, the member contracts with the responsible entity to set up and maintain the project and harvest and market the proceeds. The underlying land usually remains the property of the responsible entity or an associate and reverts to them at the conclusion of the project. The member is given rights to use a part of the land for the duration of the project.
[Historical note: PS 130.31A inserted 2/6/1999.]

[PS 130.31B] If members are not protected by a registered interest in the land that is paramount and cannot be adversely affected by any existing or subsequent mortgagee, secured creditor or transferee, the risks to the members include the following:

- (a) the landowner may have used, or may use the land as security, and if there is a default, the mortgagee or similar secured creditor may be able to rely the security and disregard the interests of the members, and
- (b) the landowner (or a liquidator of the landowner) may transfer the land (or an interest in the land) to a transferee who is not under an obligation to recognise the right of the members regarding the land.

[Historical note: PS 130.31B inserted 2/6/1999.]

D Capacity and expertise

Our policy

[PS 130.32] You will need to demonstrate that you have the capacity and expertise to carry out the duties of a responsible entity efficiently, honestly and fairly in the areas noted below.

Capacity to carry on a business

[PS 130.33] You must have the organisational structure and adequate accounting, computer, compliance and operating systems to deal with current and future operational demands.

Education and experience

[PS 130.34] You or your agents must have responsible officers with education and experience sufficient to demonstrate that you can:

- (a) operate a managed investment scheme;
- (b) understand the legal, compliance and accounting obligations of operating a managed investment scheme; and
- (c) understand the investment and operational issues of all the kinds of assets under management.

Good fame and character

[PS 130.35] We will assess whether your or your agents' responsible officers are of good fame and character by:

- (a) examining the information about those officers' past conduct given in your licence application and from our internal databases; and
- (b) making sure there are no convictions for serious fraud or dishonesty by requiring you to provide police checks.

Engaging agents

[PS 130.36] If you intend to engage any agents or external service providers to do anything in connection with your scheme or schemes, you must demonstrate that you:

- (a) have used due skill and care in choosing suitable persons; and
- (b) will monitor their ongoing performance.

Compliance

[PS 130.37] When applying for a licence, you must demonstrate that you have:

- (a) structures in place to enable you to undertake your compliance responsibilities;
- (b) the capacity to develop compliance measures and a compliance plan; and
- (c) the capacity to perform your compliance responsibilities on an ongoing basis. This includes promoting a positive attitude to compliance within your organisation.

Accountability

[PS 130.38] You must confirm your ongoing eligibility to be a licensee.

Underlying principles

[PS 130.39] Responsible entities accept for investment in their schemes the savings of ordinary Australians. These investments are better protected if they are managed by those who have the capacity to ensure that schemes are operated efficiently, honestly and fairly. Responsible entities can operate their scheme or schemes efficiently, honestly and fairly, either themselves or through agents, by having:

- (a) the organisational capacity to meet current and future operational demands;
- (b) appropriate expertise and skills;
- (c) responsible officers who are of the good fame and character; and
- (d) the structures and capacity to comply with the Law and scheme constitutions.

Explanations

Capacity to carry on a business

[PS 130.40] You will be asked to demonstrate your capacity to carry on a business by giving details in your licence application, for example, about:

- (a) the nature of your business;
- (b) any schemes you currently manage;
- (c) your organisational structure;
- (d) your anticipated growth over the next five years; and
- (e) your accounting, computer, compliance and operating systems.

[PS 130.41] Until the year 2000, we will require details about how you are dealing with issues associated with the Year 2000 date problem with computer systems and systems with embedded computer chips.

If your business is not yet operating

[PS 130.42] If your business is not yet operating, you must give enough information in your application to demonstrate that you will have, at the time you begin operating, the necessary capacity and skills to fulfil your obligations as a responsible entity. You must demonstrate in your licence application how you will ensure that you will:

- (a) appoint, monitor and retain appropriate staff and agents;
- (b) have and retain adequate accounting, compliance, computer and operational systems; and
- (c) meet the appropriate financial conditions now and on an ongoing basis.

Education and experience

[PS 130.43] We must be satisfied that the education and experience of each responsible officer or agent are adequate. They must be adequate for performing the duties of a licensee (s784(2)(c)) including meeting the licence conditions and obligations of a licensee under Chapter 5C.

Who is a responsible officer?

[PS 130.44] The statutory definition of a responsible officer is the person who performs the duties of the licensee: s9.

[PS 130.45] We recognise this is a broad definition. We consider that the directors and key senior staff of the responsible entity or its agent, who are responsible for making decisions about the ongoing operations of the scheme, should be the persons nominated as responsible officers.

[PS 130.46] The number of responsible officers named will vary with the size and activities of the responsible entity. The applicant is responsible for ensuring that all "responsible officers" are named in the application and that they satisfy the licensing criteria. However, we retain the discretion to reject the application or seek more

information if we think the overall education and experience criteria are not satisfied. [PS 130.47] Not *all* decision making staff must meet the criteria. For instance, if such persons' functions are not directly relevant to the functions of operating a scheme, or investing or managing the underlying asset, they need not be included.

Education and experience criteria

[PS 130.48] You can satisfy the education and experience criteria by appointing an agent or engaging a person with appropriate qualifications and experience. If there is only one person with the appropriate qualifications and experience, we will generally impose a licence condition that the named person or another person we approve be retained.

[PS 130.49] Foreign qualifications which have been agreed to by the National Office of Overseas Skills Recognition as comparable with the relevant Australian tertiary qualification are acceptable. You must submit the certification with your licence application.

[PS 130.50] You must have both appropriate education and experience. It is possible for these criteria to be met by combining the qualifications and experience of more than one person. However, we consider that the requirement for a minimum number of years experience in the industry associated with the scheme asset must be met individually. The benefits of experience are gained over an accumulation of time. Aggregating short terms of experience of a number of people is not an adequate substitute.

[PS 130.51] The table below sets out what we consider are the necessary qualifications and length of experience required to operate a scheme or schemes efficiently, honestly and fairly. If you meet the requirements set out in Column A, we think you will meet the criteria set out in [PS 130.34]. However, if you can meet the requirements in Column B you may be able to satisfy us that you meet the standards set out in [PS 130.34].

<i>Function</i>	<i>A</i> <i>Preferred education and experience</i>	<i>B</i> <i>Acceptable education and experience</i>
1 Investing or operating the kinds of scheme assets under management	A university degree relevant to the asset under management and at least one person with a minimum of 2 years relevant experience over the past 5 years in the industry associated with the assets; and	At least one person with a minimum of 5 years relevant experience over the past 8 years in the industry associated with the assets under management; and
2 Operating a scheme and understanding the relevant obligations	Two years experience over the past 5 years in the investment management industry with a scheme of a comparable size and asset type. Relevant experience must enable you to demonstrate knowledge and ability to discharge the obligations of a licensee, including the duties and responsibilities of a responsible entity.	Persons who together have educational qualifications and experience (whether in the relevant asset type or other funds management) which demonstrate knowledge and ability to discharge the obligations of a licensee, including the duties and responsibilities of a responsible entity.

[PS 130.52] Generally, the following educational qualifications are a prerequisite in order to obtain a licence to operate the kinds of schemes listed below.

Underlying asset
Financial assets

Qualifications

Tertiary qualification in business, accounting or

Derivatives	actuarial studies.
Mortgages	
Member discretionary master funds and similar schemes	
Primary production	Tertiary qualifications relating to the underlying product eg horticulture, viticulture.
Direct property	A real estate agent's licence or a tertiary qualification in real estate or property.
Commercial horse breeding schemes	Applicants need not meet any specific educational requirements. However, they must meet the experience test.
Time-sharing schemes	A real estate agent's licence or a tertiary qualification in real estate or property.

Good fame and character

[PS 130.53] The Law (s784(4)(c) and (d)) requires that we have regard to:

- (a) any conviction of serious fraud of a responsible officer during the last ten years; and
- (b) to any reason why we believe an officer is not of good fame and character.

[PS 130.54] To assist us to form a view, each responsible officer or those of any agent must declare any matters in the last ten years which reflect on their character and honesty. These matters relate to their insolvency, membership of professional or industry associations and history of convictions (if any). You must arrange an Australian Federal Police check for them and attach the completed forms to your application.

[PS 130.55] A licence application must be accompanied by at least two character references about the past conduct and good character of the responsible officers named in your application. The detailed requirements of the references are set out in the *ASIC Licensing Kit*: see [LIC 1].

Engaging agents

[PS 130.56] A responsible entity can appoint an agent, or engage a person, to do anything that it is authorised to do in connection with the scheme: s601FB(2).

[PS 130.57] In your application, you will need to satisfy us that you can meet your obligations in operating the scheme. You will need to demonstrate that you have taken due care and diligence to ensure that the agent has the capacity to carry out the delegated functions.

[PS 130.57A] If you are using or propose to use an agent to perform important functions for the operation of the scheme, you must satisfy us that you have arrangements to ensure that the agent has appropriate insurance to protect the scheme from fraud by the officers of the agent.

[Historical note: PS 130.57A inserted 2/6/1999.]

[PS 130.58] You may outsource most of the functions associated with operating a scheme. However, you must satisfy us that you have the expertise to assess the ability of all the agents and to monitor their ongoing performance.

Custodian of scheme property

[PS 130.59] If you intend to appoint a custodian to hold scheme property, you will have to meet the requirements in [PS 130.57]. You must also answer further questions designed to demonstrate that you have appropriate processes and arrangements in place for the selection of a custodian who meets the standards for holding scheme property. These standards are set out in Policy Statement 133 *Managed investments: Scheme property arrangements* [PS 133].

Compliance

[PS 130.60] To demonstrate that you can comply with the Law and your scheme constitution, you need, for example, to:

- (a) nominate the members of your compliance committee, if you have one, and describe how they will fulfil their responsibilities (see [PS 136.76A]–[PS 136.76E] for some guidance on the meaning of the phrase “substantially involved in business dealings, or in a professional capacity, with the responsible entity”);
- (b) detail the experience and qualifications of the compliance officer, if you have one;
- (c) describe the functional, structural and reporting arrangements which will ensure that your operational functions will continuously meet compliance obligations;
- (d) describe how you will integrate a positive attitude to compliance into day to day operations; and
- (e) describe the arrangements for ongoing staff training.

[Historical note: PS 130.60 amended 4/11/1998 by inserting in para(a) the words: “(see [PS 136.76A]–[PS 136.76E] for some guidance on the meaning of the phrase “substantially involved in business dealings, or in a professional capacity, with the responsible entity”).”]

[PS 130.61] These responses will be assessed against the compliance plan for schemes operated by you and examined when we conduct surveillance visits.

Accountability

Annual reporting

[PS 130.62] As part of the *Annual Statement by a Dealer or Investment Adviser* (Form 706), you will have to confirm that you are of the belief that you continue to satisfy key eligibility criteria, such as:

- (a) the education and experience of your responsible officers;
- (b) the adequacy of your financial resources to carry on your business as a going concern;
- (c) the currency and adequacy of your professional indemnity insurance policy;
- (d) the adequacy of your compliance measures and the promotion of a positive attitude to compliance within your organisation;
- (e) compliance with your compliance plan and constitution; and
- (f) the adequacy of the insurance maintained by agents.

[Historical note: PS 130.62(f) inserted 2/6/1999.]

Exception reporting

[PS 130.63] As a condition of your licence, you will be required to notify us of any

material change which might reasonably be expected to prompt us to reconsider your continuing eligibility. Examples of aspects of change which should be notified include loss of key personnel, a change in the nature of your business, a change in custodial arrangements and a change in your financial position.

E Complaints resolution

Our policy

[PS 130.64] We will place conditions on your licence that you must:

- (a) become a member of an external complaints resolution scheme approved by us which deals with complaints about you as a responsible entity, by 1 November 1999 or a later date announced by us; and
- (b) have in place at all times, to deal with complaints from members, complaints handling procedures that are in accordance with Australian Standard AS 4269:1995, *Complaints Handling*, as applied in reg 7.3.02B(5).

[Historical note: PS 130.64 amended by replacing in para (a) "1 July 1999" with "1 November 1999".]

Underlying principles

[PS 130.65] Investor protection will be increased and an alternative to expensive legal action will be provided for both investors and industry by having adequate internal and external procedures for complaints resolution.

Explanation

[PS 130.66] Requiring a responsible entity to have adequate procedures for complaints resolution is consistent with the direction taken by various sectors of the financial industry and by Parliament. For example, a responsible entity that gives investment advice is already required under the Regulations to belong to an external complaints resolution scheme approved by us by 1 October 1998 and to have complaints handling procedures in place in accordance with Australian Standard AS 4269: 1995, *Complaints Handling*. Policy Statement 134 *Managed investments: Constitutions*, sets out what a constitution must contain about complaints handling systems at [PS 134.23].

Key terms

[PS 130.67] In this policy statement, a reference to:

"Managed Investments Act" is to the *Managed Investments Act 1998*;

"responsible officer" is to a person who satisfies the definition of the term "responsible officer" in s9 of the Law;

"scheme" is to a managed investment scheme;

"s784" (for example) is to a section of the Law; and

"the Law" is to the Corporations Law.

Related information

[PS 130.68]

Headnotes

Managed investment schemes, granting a dealers licence to authorise a responsible entity to carry on a securities business or operate a managed investment scheme, how to apply for a licence, capacity to carry on a business, education and experience criteria for responsible officers, good fame and character, engaging agents, compliance, complaints resolution.

Policy statements and practice notes

Policy Statement 116 *Investment advisory services: Licensing and "independent" advisory services* [PS 116]

Policy Statement 123 *Investment advisory services: Superannuation advice* [PS 123]

Policy Statement 131 *Managed investments: Financial requirements* [PS 131]

Policy Statement 132 *Managed investments: Compliance plans* [PS 132]

Policy Statement 133 *Managed investments: Scheme property arrangements* [PS 133]

Policy Statement 134 *Managed investments: Constitutions* [PS 134]

Policy Statement 135 *Managed investments: Transitional issues* [PS 135]

Policy Statement 136 *Managed investments: Discretionary powers and closely related schemes* [PS 136]

Class orders and pro formas

[PF 189]

Legislation

Chapter 5C, s601EB, 601FA, Part 7.3, s780(2), 784(2), (4), 786, reg 7.3.02

Policy proposal papers

Financial requirements of a responsible entity

Compliance plans for managed investment schemes

Scheme property arrangements

Constitutional issues

Transitional issues

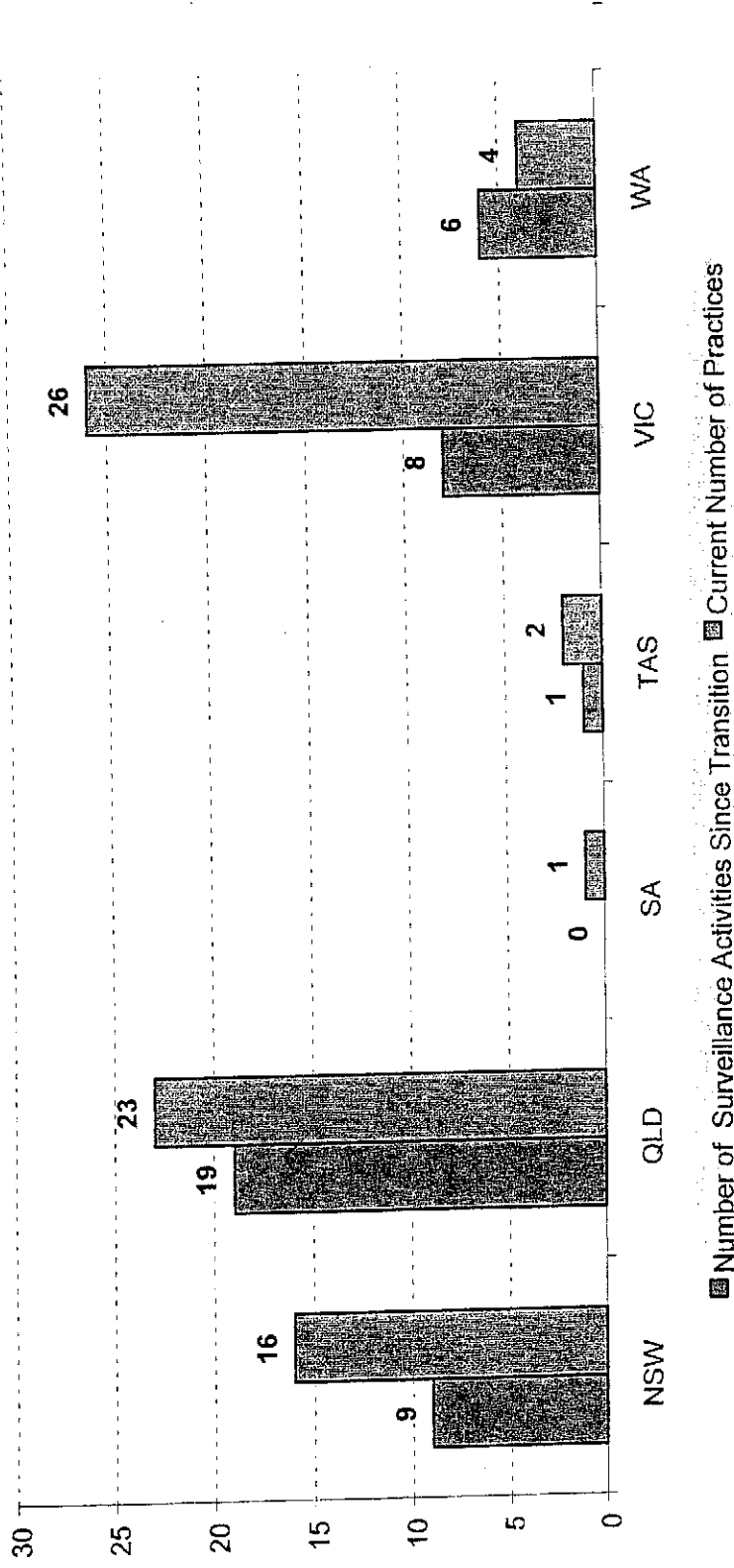
Exemptions and modifications

Media and information releases

[IR 98/9], [IR 98/10], [IR 99/18]

ANNEXURE 6

Licensed Mortgage Practices



ANNEXURE 7

MEDIA RELEASE



ASIC

Australian Securities &
Investments Commission

Sunday 25 February 2001

01/055

EMBARGOED UNTIL 8.30AM SUNDAY 25 FEBRUARY 2001

ASIC LAUNCHES MAJOR INVESTIGATION INTO SOLICITORS MORTGAGE SCHEMES

Mr David Knott, Chairman of the Australian Securities and Investments Commission (ASIC), today announced a major investigation into the financial status of Australia's unlisted solicitors mortgage investment schemes.

The initial focus of ASIC's investigation is on runout mortgage schemes which are being managed by solicitors and finance brokers throughout Australia.

Runout schemes are those which did not make the transition to ASIC's tougher managed investments regulatory regime in 1999. ASIC allowed them until 31 October 2001 to wind up their affairs in an orderly manner under the continuing supervision of the Law Societies (in Queensland, NSW, Victoria and Tasmania) and the Finance Brokers Institute of South Australia Inc. In Western Australia a small number of runout schemes have been extended the same deadline for winding up.

Under ASIC's guidelines these runout schemes are prohibited from accepting new mortgage investors during the two-year wind-up period.

Mr Knott explained that:

'Since late last year we have been building up a picture about the financial status of these schemes.

'It is clear that a number of them have serious default rates. We expect those defaults to become worse as the wind-up deadline approaches.

'We are therefore launching the biggest enquiry of this type ever undertaken by ASIC. To assist with that task, we have retained the services of Mr Tony Hodgson, one of Australia's leading insolvency experts. Mr Hodgson will work with us in addressing how best to protect the interests of investors in these funds', he said.

ASIC has written to all of the State law societies, which administer the schemes, seeking information about the schemes within their jurisdiction. ASIC has also written to all scheme operators requesting information about their loan books.

'Our first priority is to obtain a better national database on the health status of these funds; and to target our investigations to those schemes where investors face the greatest risk', Mr Knott said.

While ASIC's investigations are primarily designed to identify the best steps available to minimise investor loss, issues of negligence and misconduct will also be considered.

'We will be examining in conjunction with Mr Hodgson whether circumstances justify commencement of civil or criminal proceedings against scheme operators', Mr Knott said.

ASIC expects to complete the first phase of its work by 30 June 2001 but believes that the project will extend through the second half of the year.

'This will not be a quick or an easy project for ASIC. It is not realistic to expect that investor losses will be recovered, but our intervention should provide opportunity to minimise these losses and maximise consumer redress', Mr Knott said.

ASIC's investigation will be complemented by the cooperation of a number of agencies and organizations that will provide consumer advice to affected investors. They include:

- Centrelink's Financial Information Service
- Financial Planning Association
- National Information Centre for Retirement Investments.

For further information see ASIC's consumer information sheet, issued today. The consumer information sheet gives consumers useful information about how to contact these organizations, together with additional relevant information.

In addition, ASIC has published a list of runout schemes on its investor website www.fido.asic.gov.au.

For further information contact:
Kate Harvey
ASIC Media Unit
Telephone: 03 9280 3553
Mobile: 0401 985 966



ASIC

Australian Securities & Investments Commission

CONSUMER INFORMATION SHEET

Mortgage schemes run by solicitors and finance brokers

For many years, solicitors and finance brokers ran investment schemes where groups of investors could lend money to borrowers who mortgaged land as security.

In December 1999, new standards were set up to protect investors. By law, any scheme unable to meet these new standards must stop attracting investors and must wind up their operations by 31 October 2001.

Over the past few months the Australian Securities and Investments Commission (ASIC) has become increasingly concerned about the financial position of these schemes. We have received an increasing number of complaints from consumers and so have stepped in to investigate.

Have you invested in a scheme being wound up?

Check the names on www.fido.asic.gov.au or call our Infoline on 1300 300 630.

Is your scheme facing trouble?

Only if your scheme's mortgages are in default. A mortgage is in default when the borrower has missed paying interest or the principal. Some schemes have many defaulting mortgages, while others have only a few or none at all.

Your scheme manager (your solicitor or finance broker) should have told you already if a default has occurred on a mortgage affecting you. If you are not sure, contact the manager.

Will you lose your money if a mortgage defaults?

Not necessarily. The borrower may succeed in raising the money to pay you. Or you may get your money back (the amount you lent, the missed interest payments and other costs) if you can sell the mortgaged land. However, if the borrower cannot pay, and if the mortgaged land cannot be sold for what you are owed, then you face a loss.

If your solicitor (or broker in SA) has acted inappropriately, you may have a claim against them which could be covered by their insurance arrangements (see below).

If your mortgage is in default, what can you do?

It all depends on the rules of your mortgage scheme. Some investors can use their full legal rights as mortgagees and sell the mortgaged property. Other investors may have signed over these rights to the scheme managers, and will have to wait until the scheme is wound up.

If you do not know where you stand, get legal advice from a different solicitor in a different firm from the one who is managing your mortgage. A solicitor who is independent of your mortgage scheme may be best placed to advise you.

What will ASIC do for you?

ASIC will be reviewing these schemes and wants them to wind up in an orderly way so that investors will get the best deal. While further delay in closing schemes can make losses worse, we will consider doing that, if it is truly in the best interests of investors.

ASIC will also investigate where we find evidence of dishonest or negligent scheme managers, so that the community is protected from these people in future.

If you have suffered from fraud, dishonesty or negligence, please contact us by e-mail infoline@asic.gov.au or by phone on **1300 300 630** or write to us at ASIC Mortgage Investigation Team, ASIC, GPO Box 9827, Brisbane QLD 4001.

If your scheme was run honestly and diligently but still lost money through the ups and downs of the market, the law gives us no power to get involved.

Other useful contacts

If you have a complaint about the professional conduct of your solicitor (or broker in SA), phone the relevant professional body in your State:

- The Law Society of New South Wales: ph 02 9926 0333
- Law Institute of Victoria: ph 03 9607 9311
- Finance Brokers Institute of South Australia: ph 08 8267 1966
- Law Society of Tasmania: ph 03 6234 4133
- Law Society of Queensland Inc: ph 07 3842 5888.

In Western Australia it is unlikely that your mortgage was arranged by a solicitor and you should contact ASIC on 08 9261 4000.

If you would like general information about mortgage investment issues, contact:

- The **Financial Planning Association (FPA)**: phone toll free on 1800 626 393 or visit their website www.fpa.asn.au

The FPA will assist investors who have been negatively impacted or want further information about mortgage investment schemes. Initial advice will be provided free of charge and any ongoing advice would be subject to negotiation on commercial terms.

- The **National Information Centre for Retirement Investments (NICRI)**: phone toll free on 1800 020 110 or visit their website www.nicri.org.au

NICRI provides up-to-date independent information to assist people to make the best possible investment decisions they can. It is free, independent, confidential service.

- **Centrelink's Financial Information Service (FIS):** phone 13 2300 or visit www.centrelink.gov.au

FIS provides a free, independent and expert service that is available to anyone. It will provide financial information including how to recognise and pursue financial options, make better financial decisions, and understand investment products and how they work.

For more detailed advice about your individual circumstances, you will generally have to pay to consult a solicitor (legal advice) or a licensed financial planner (financial advice).

Related information

For more detail about the different types of mortgage investment schemes, see our information sheet *Types of mortgage investment schemes*.

