



**ASIC**

Australian Securities & Investments Commission

CONSULTATION PAPER 287

# Remaking ASIC class order on mortgage schemes and proposed relief for multiple withdrawal periods

June 2017

## About this paper

This consultation paper sets out ASIC's proposal to remake our class order on mortgage investment schemes. Under the *Legislation Act 2003*, this class order will expire ('sunset') if not remade.

We are seeking feedback from operators of mortgage investment schemes on our proposal to remake Class Order [CO 02/238] *Mortgage schemes: Ch 5C and disclosure relief*, which is due to expire on 1 October 2017.

Note: The draft ASIC instrument is available on our website at [www.asic.gov.au/cp](http://www.asic.gov.au/cp) under CP 287.

We are also seeking feedback on whether we should grant relief to allow the constitution of a registered managed investment scheme to provide for multiple withdrawal periods.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Document history

This paper was issued on 22 June 2017 and is based on the Corporations Act as at the date of issue.

### Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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## The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information.

We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on certain mortgage investment schemes and in relation to relief for multiple scheme withdrawal periods. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section D, 'Regulatory and financial impact'.

### Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

Please note we will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any personal or financial information) as confidential.

Please refer to our privacy policy at [www.asic.gov.au/privacy](http://www.asic.gov.au/privacy) for more information about how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by 4 August 2017 to:

Mai Go  
Lawyer, Investment Managers and Superannuation  
Australian Securities and Investments Commission  
Level 7, 120 Collins Street  
Melbourne VIC 3000  
email: [mai.go@asic.gov.au](mailto:mai.go@asic.gov.au)

## What will happen next?

<b>Stage 1</b>	22 June 2017	ASIC consultation paper released
<b>Stage 2</b>	4 August 2017	Comments due on the consultation paper
<b>Stage 3</b>	By 1 October 2017	Commencement of remade instrument

## A Background

### Key points

Legislative instruments, such as class orders, are repealed automatically, or 'sunset', after 10 years, unless action is taken to exempt or preserve them. We will consult on all sunseting legislative instruments that have more than a minor or machinery regulatory impact.

### Purpose of 'sunseting' legislative instruments

- 1 Under the *Legislation Act 2003*, legislative instruments cease automatically, or 'sunset', after 10 years, unless action is taken to exempt or preserve them. Section 50(1) repeals a legislative instrument on either 1 April or 1 October—whichever date occurs first on or after the 10th anniversary of its registration on the Federal Register of Legislation (FRL). Repeal does not undo the past effect of the instrument.
- 2 To preserve its effect, a legislative instrument, such as a class order, must be remade before the sunset date. The purpose of sunseting is to ensure that instruments are kept up to date and only remain in force while they are fit for purpose.

### Our approach to remaking legislative instruments

- 3 If it is necessary to remake a legislative instrument, our focus is on making it clear and user friendly. We will also, where possible, simplify and rationalise its content and conditions. For example, we will remove or reduce an obligation or burden in a legislative instrument if we are able to do so without undermining ASIC's priorities of promoting investor and consumer trust and confidence and ensuring fair and efficient markets.
- 4 We will consult affected stakeholders on all ASIC legislative instruments that have more than a minor or machinery regulatory impact, and are subject to sunseting, to ensure:
  - (a) we are able to carefully consider the continuing regulatory and financial impact of the instrument; and
  - (b) the instrument retains its effectiveness in addressing an identified issue or problem.
- 5 Generally, a Regulation Impact Statement (RIS) is required for new and amended policy that has a significant regulatory impact: see the [Australian Government Guide to Regulation](#). We will review, including public

consultation, all class orders that have a significant regulatory impact before the scheduled sunset date. Where our review finds that a class order is not operating effectively and efficiently, we will prepare a RIS to assess any proposed changes to the class order that are not minor and machinery. Where the class order is operating effectively and efficiently, we will remake the instrument without substantive changes.

## B Remaking ASIC class order

### Key points

We are proposing to remake Class Order [CO 02/238] *Mortgage schemes: Ch 5C and disclosure relief*, which sunsets on 1 October 2017.

We have formed the preliminary view that most sections of relief in the class order are operating effectively and efficiently, and continue to form a useful part of the legislative framework. We are proposing to not remake one section of relief because we consider it is no longer necessary. We seek your feedback on these proposals.

The class order has been redrafted using ASIC's current style and format, while largely preserving the current effect of the instrument (except for the section of relief that we are proposing will not be remade). The draft ASIC instrument, which reflects the amendments proposed in this paper, is available on our website at [www.asic.gov.au/cp](http://www.asic.gov.au/cp) under CP 287.

### Class Order [CO 02/238] *Mortgage schemes: Ch 5C and disclosure relief*

#### Background

- 6 [CO 02/238] provides five separate forms of relief in relation to mortgage investment schemes:
- (a) registration, Australian financial services (AFS) licensing and disclosure relief for small-scale schemes with no more than 20 members (see paragraphs 7–9);
  - (b) registration relief in relation to individual mortgages in a scheme (see paragraphs 10–12);
  - (c) registration relief for small 'industry-supervised' schemes (see paragraphs 13–15);
  - (d) transitional registration relief for 'run-out' schemes (see paragraphs 16–17); and
  - (e) withdrawal relief for individual mortgages in a scheme (see paragraphs 18–20).

#### Schemes with no more than 20 members

- 7 Section 2 of [CO 02/238] exempts operators of certain small-scale mortgage investment schemes with no more than 20 members from the requirements under the *Corporations Act 2001* (Corporations Act) to register a scheme, hold an AFS licence, or give Product Disclosure Statement (PDS) disclosure. Section 2 also provides related relief to persons other than the operator.



- 8 The requirement under s601ED of the Corporations Act to register a scheme would generally not apply if the operator of a scheme with no more than 20 members was not in the business of promoting managed investment schemes. However, if the view is taken that there is a separate scheme for each mortgage entered into under a scheme promoted by an operator, and there are several mortgages made from time to time, the operator's activities might be regarded as carrying on a business of promoting managed investment schemes for the purposes of s601ED(1)(b). We have granted relief to ensure that in this situation the mortgage investment scheme does not need to be registered.
- 9 The AFS licensing and PDS relief reflect the position under s765A(1)(s) of the Corporations Act that an interest in a scheme with no more than 20 members, and which is not promoted by a person in the business of promoting managed investment schemes, is not a financial product (unless subject to a determination under s601ED(3) of the Corporations Act).

#### **Registering a mortgage business as a scheme**

- 10 Section 3 of [CO 02/238] exempts the operator of a mortgage investment scheme from the registration requirement under s601ED to the extent that s601ED may require that a separate scheme be registered for each mortgage operated under that scheme.
- 11 We consider that for an operator of a mortgage investment scheme there may be uncertainty as to whether such a scheme would be characterised as:
- (a) a single managed investment scheme; or
  - (b) a single managed investment scheme and a number of individual managed investment schemes (see *ASIC v Knightsbridge Managed Funds Ltd* [2001] WASC 339 and *Re Idylic Solutions Pty Ltd & ASIC v Hobbs* [2012] NSWSC 1276).
- 12 Our relief in section 3 of [CO 02/238] eliminates the legal uncertainty by making it clear that when an operator registers a mortgage investment scheme, the operator does not need to separately register a scheme for each mortgage operated under that scheme.

Note: Section 6 of [CO 02/238] modifies the Corporations Act for mortgage investment schemes to which section 3 of [CO 02/238] applies: see paragraphs 18–20.

#### **Small industry-supervised schemes**

- 13 Section 4 of [CO 02/238] exempts operators of certain small mortgage investment schemes from the requirement to register the scheme under s601ED if it:
- (a) is operated under the supervision of an industry supervisory body (ISB);
  - (b) complies with any applicable rules and directions of the ISB; and
  - (c) meets certain conditions.

- 14 The current ISBs listed in section 4 of [CO 02/238] are the Law Institute of Victoria and the Law Society of New South Wales.
- 15 The key features of a mortgage investment scheme to which this relief may apply are:
- (a) the principal of loans outstanding (when aggregated with related unregistered schemes) does not exceed \$7.5 million;
  - (b) interests in the scheme are not issued unless the operator reasonably believes the person has received a copy of the PDS that has been lodged with the relevant ISB; and
  - (c) the scheme is operated in accordance with the ‘ISB conditions’, which are a set of conditions set out in [CO 02/238] that include conditions relating to loan valuation, restrictions on the jurisdictions in which interests may be issued, a prohibition on public advertising, providing for investor choice of mortgages, and the holding of cash in designated trust accounts.

#### **Run-out schemes (transitional relief)**

- 16 Section 5 of [CO 02/238] exempts the operator of a ‘run-out’ mortgage investment scheme from the need to register the scheme under s601ED. Conditions of this relief include that the scheme:
- (a) is operated under the supervision of, and in compliance with any applicable rules and directions of, an ISB;
  - (b) complies with the ISB conditions; and
  - (c) complies with the requirement that no new loans are made under the scheme or any related scheme.
- 17 This relief is transitional in nature and was provided to enable the orderly winding down of mortgage investment schemes where the operator decided not to comply with the requirements introduced by the *Managed Investments Act 1998* or to rely on other relief (e.g. to become a small industry-supervised scheme under section 4 of [CO 02/238]).

#### **Modification in relation to registering mortgage businesses**

- 18 Section 6 of [CO 02/238] modifies the withdrawal provisions in s601GA(4) and Pt 5C.6 of the Corporations Act for mortgage investment schemes to which section 3 of [CO 02/238] applies to allow the application of the requirements on a mortgage-by-mortgage basis, rather than for the scheme as a whole. In particular, the relief provides that:
- (a) each reference in those provisions to a scheme which is liquid (or not liquid) is taken to be a reference to a mortgage administered under the scheme which is liquid (or not liquid); and
  - (b) each reference to members of the scheme is taken to be a reference to members who have interests relating to the mortgage.

- 19 We provide relief in recognition that where a mortgage investment scheme relates to different mortgages in which particular members have an interest, provisions covering withdrawal from a scheme that is not liquid may not apply appropriately.
- 20 The relief allows:
- (a) a different withdrawal period to be specified in the constitution for different mortgage arrangements; and
  - (b) differences in the likely ability to realise a mortgage for its market value to be recognised.

## Proposal

**B1** To preserve its effect beyond the sunset date of 1 October 2017, we propose to continue the relief currently given by [CO 02/238] (with the exception of the transitional relief in section 5) in a new legislative instrument that reflects current drafting practice: see draft ASIC Corporations (Mortgage Investment Schemes) Instrument 2017/XX attached to this consultation paper. You can access the current instrument at [www.legislation.gov.au](http://www.legislation.gov.au) by clicking on the following direct link: [\[CO 02/238\]](#).

The changes proposed are to:

- (a) temporarily extend, until one year from the date when the new instrument commences, the relief currently given under section 4 of [CO 02/238] for small industry-supervised mortgage investment schemes to allow for a review of this relief in light of the potential impact of s258 of the Legal Profession Uniform Law, which will come into effect on 1 July 2018;
- (b) discontinue the transitional relief for 'run-out' mortgage investment schemes, which is currently given under section 5 of [CO 02/238];
- (c) update the name of the legislative instrument;
- (d) reflect current drafting practice and update the format of the current document;
- (e) refine the drafting to give greater clarity and accuracy, including by replacing the term 'mortgage business' with 'mortgage investment scheme' and updating the definition to more accurately reflect the types of schemes covered by the relief;
- (f) update legislative references and definitions; and
- (g) correct any minor drafting errors.

### *Your feedback*

B1Q1 Do you agree with the proposal to continue the relief in [CO 02/238] on the proposed terms? If not, please provide reasons.

B1Q2 Do you agree with the proposal to update the definition of 'mortgage business'?

B1Q3 Should the scheme registration relief for individual mortgages in a mortgage investment scheme (currently in section 3 of [CO 02/238]) be subject to restrictions or conditions. For example, for new mortgages, should holders of a particular mortgage be permitted to decide by extraordinary resolution to terminate the operator's role and transfer the mortgage to another responsible entity?

## Rationale

21 We have reached the preliminary view that [CO 02/238] is operating effectively and efficiently, and continues to form a useful part of the legislative framework. Section 5 of [CO 02/238] contains transitional relief for 'run-out' schemes that we consider is no longer necessary. We are not aware of significant issues with the current operation of this class order.

## Definition of 'mortgage business'

22 We propose to update the definition of 'mortgage business' in [CO 02/238] to reflect contemporary terminology, and the way we currently define mortgage schemes: see, for example, [Regulatory Guide 45 Mortgage schemes: Improving disclosure for retail clients](#) (RG 45).

23 The proposed definition will mean that relief will apply to schemes that have, or are likely to have, at least 50% of non-cash assets invested in mortgage loans, and 100% of assets invested in mortgage loans or in an account with an Australian ADI. In our view, this definition more accurately captures the types of schemes to which this relief is intended to apply.

## Schemes with no more than 20 members

24 We have reached the preliminary view that section 2 of [CO 02/238] is operating effectively and efficiently, and are proposing that this relief be continued on substantially the same terms.

## Registering a mortgage business as a scheme

25 We have reached the preliminary view that section 3 of [CO 02/238] is operating effectively and efficiently, and are proposing to continue this relief on substantially the same terms.

26 We consider there may remain legal uncertainty as to the characterisation of certain mortgage investment schemes, and so relief should be continued to make it clear that an operator will not have to register a separate scheme for each mortgage arrangement in the scheme. We consider this relief necessary to ensure an outcome that is pragmatic and consistent with the intended purpose of the legislation.

- 27 Giving relief so an operator does not have to register a scheme relating to each mortgage separately means members of the scheme will not have the right that they would have had to replace the responsible entity by extraordinary resolution. In a broader scheme that will be registered, an extraordinary resolution would require support from members with interests in other mortgages who may not vote if concerns about mismanagement or lack of service are restricted to other mortgages.
- 28 We are seeking feedback on whether restrictions or conditions should be included for this registration relief, such as whether, for new mortgages, members with an interest in a particular mortgage should be permitted by an extraordinary resolution of those members to decide to terminate the operator's role and transfer the mortgage to another responsible entity.

#### **Small industry-supervised schemes**

- 29 The relief in section 4 of [CO 02/238] relates to the operation of certain small mortgage investment schemes under the supervision of the Law Institute of Victoria and the Law Society of New South Wales.
- 30 We understand that there are currently a small number of mortgage investment schemes being operated under the supervision of the Law Institute of Victoria in accordance with this relief.
- 31 From 1 July 2018, section 258 of the Legal Profession Uniform Law would prohibit the promotion or operation of a managed investment scheme in New South Wales or Victoria by a law practice or a related entity. We understand that the relief in section 4 of [CO 02/238] will not be necessary or useful where this prohibition is in effect.
- 32 Following a preliminary review, we consider that the relief in section 4 of [CO 02/238] should be extended for a period of one year from the date the new instrument commences to allow for a future review of the effectiveness and efficiency of the relief in light of the outcome of s258 on the relevant supervisory arrangements, and other relevant circumstances at the time. A temporary extension of the relief will minimise disruption to the small number of schemes currently relying on the relief.

#### **Run-out schemes (transitional relief)**

- 33 We have reached the preliminary view that the relief in section 5 of [CO 02/238] is no longer necessary. This is because the relief was transitional in nature and was intended to facilitate the winding down of certain mortgage investment schemes 15 years ago.

**Modification in relation to registering mortgage businesses**

- 34 We have reached the preliminary view that section 6 of [CO 02/238] is operating effectively and efficiently, and continues to form a useful part of the legislative framework.
- 35 In our view, disaggregation for liquidity purposes remains a useful part of the regulatory settings for mortgage investment schemes to which section 3 of [CO 02/238] applies. We consider it desirable to have the withdrawal provisions apply on a mortgage-by-mortgage basis, rather than applying to the scheme as a whole.

## C Relief for multiple withdrawal periods

### Key points

We are seeking feedback on whether we should grant relief to allow the constitution of a registered managed investment scheme (scheme) to provide for multiple withdrawal periods. The relief would modify Pt 5C.6 of the Corporations Act such that the shortest withdrawal period would be the relevant withdrawal period for the purpose of the liquidity test in s601KA.

### Multiple withdrawal periods for a scheme

- 36 In July 2007, we consulted on whether relief should be granted to allow for multiple withdrawal periods in scheme constitutions: see Section 3 of [Consultation Paper 84](#) *Managed investment schemes: Withdrawal rights and scheme liquidity* (CP 84). We sought feedback on whether relief should be granted because some scheme constitutions have provision for different withdrawal periods to operate in relation to different interests at the one time, but it is not clear that this is consistent with the requirements of the Corporations Act that require a test of whether an asset is a liquid asset by reference to a withdrawal period for the scheme.
- 37 To date, we have not taken action to enforce a view that it is not consistent with the Corporations Act for constitutions to provide for multiple withdrawal periods. This no-action position only applies to a scheme if the responsible entity uses the shortest withdrawal period for the purposes of determining whether any property is a liquid asset under s601KA(6) of the Corporations Act.
- 38 We consider that the proposed relief and the rationale for the relief in Section 3 of CP 84 are still relevant.

### Proposal

- c1 To allow scheme constitutions the flexibility to provide for multiple withdrawal periods, we propose to grant relief to modify Pt 5C.6 of the Corporations Act such that the shortest withdrawal period would be the relevant withdrawal period for the purpose of the liquidity test in s601KA. The proposed relief would be conditional on the responsible entity publishing a statement on its website that it is relying on this relief.

*Your feedback*

- C1Q1 Should we grant relief to allow scheme constitutions to provide for multiple withdrawal periods? Would allowing multiple withdrawal periods raise any investor protection issues?
- C1Q2 If multiple withdrawal period relief is provided, what conditions should apply?
- C1Q3 Would our proposal be consistent with current market practice? If not, please give details on the amount and nature of any additional costs that would be incurred by responsible entities in operating schemes in accordance with our proposals.

## Rationale

- 39 A scheme is liquid if 80% of the scheme's assets can be realised within the period specified in the constitution for satisfying withdrawal requests while the scheme is liquid: s601KA.
- 40 If a scheme constitution provides for more than one withdrawal period to apply at the same time (e.g. because there are different classes of interests on issue), there is no definitive answer to whether a scheme is liquid and therefore the provisions of Pt 5C.6 cannot sensibly operate. This means that Pt 5C.6 arguably does not permit a constitution to provide for more than one withdrawal period to apply at any one time.
- 41 We are proposing to grant relief to allow scheme constitutions the flexibility to provide for multiple withdrawal periods. The relief will modify Pt 5C.6 of the Corporations Act such that the shortest withdrawal period would be the relevant withdrawal period for the purpose of the liquidity test in s601KA.
- 42 The proposed relief would be conditional on the responsible entity publishing a statement on its website that it is relying on this relief.
- 43 In our view, providing such relief would be consistent with the position that members may generally have different withdrawal rights as long as one group of members is not unreasonably disadvantaged.



## D Regulatory and financial impact

- 44 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:
- (a) facilitating the operation of certain mortgage investment schemes where strict compliance with the law would be impossible or disproportionately burdensome;
  - (b) addressing unintended consequences of provisions in the Corporations Act as they apply to certain mortgage investment schemes, and to schemes with constitutions that provide for multiple withdrawal periods; and
  - (c) not compromising intended investor protections.
- 45 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:
- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;
  - (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
  - (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).
- 46 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC will not give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 47 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:
- (a) the likely compliance costs;
  - (b) the likely effect on competition; and
  - (c) other impacts, costs and benefits.
- 48 See 'The consultation process', p. 4.

## Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services  Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act  Note: This is a definition contained in s761A.
ASIC	Australian Securities and Investments Commission
Australian ADI	An Australian authorised deposit-taking institution—has the meaning given in s9 of the Corporations Act
[CO 14/26] (for example)	An ASIC class order (in this example numbered 14/26)  Note: Legislative instruments made from 2015 are referred to as ASIC instruments.
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
ISB	An industry supervisory body
mortgage investment scheme	A managed investment scheme, the only investments of which are mortgages over real estate and deposits at Australian ADIs
PDS	Product Disclosure Statement—a document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act  Note: See s761A for the exact definition.
Pt 5C.6 (for example)	A part of the Corporations Act (in this example numbered 5C.6), unless otherwise specified
RIS	Regulation Impact Statement
s25 (for example)	A section of the Corporations Act (in this example numbered 25), unless otherwise specified
sunsetting	The practice of specifying a date at which a given regulation or legislative instrument will cease to have effect