ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 99

Mortgage schemes—improving disclosure for retail investors

July 2008

About this paper

This consultation paper seeks your feedback on proposals to improve disclosure for retail investors in the unlisted mortgage scheme sector and advertising standards in the mortgage scheme sector generally.

It includes a draft regulatory guide with proposals for improved disclosure to help retail clients better understand and assess mortgage schemes.

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 8 July 2008 and is based on the Corporations Act as at 8 July 2008.

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.

Contents

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.

Making a submission

We will not treat your submission as confidential, and may make it publicly available, unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 5 August 2008 to:

Anthony Graham
Strategic Policy
Australian Securities and Investments Commission
GPO Box 9827
Melbourne VIC 2001
facsimile: 03 9280 3306
email: policy.submissions@asic.gov.au

What will happen next?

Stage 1	8 July 2008	ASIC consultation paper released
Stage 2	5 August 2008	Comments due on the consultation paper
Stage 3	By 2 September 2008	Regulatory guide released

A Background

1 In August 2007, ASIC published Consultation Paper 89 *Unlisted, unrated debentures—improving disclosure for retail investors* (CP 89), which proposed an 'if not, why not' approach of disclosing against key benchmarks for debentures. Final benchmarks and disclosure requirements were published in October 2007 in Regulatory Guide 69 *Debentures—improving disclosure for retail investors* (RG 69).

2 In CP 89, we foreshadowed that we would consider whether to apply the 'if not, why not' approach of disclosing against key benchmarks to other sectors.

3 Debt and equity market turbulence since late 2007 and a cyclical softening in the real property market have increased the financial stress on some sectors where retail investors are exposed, such as the unlisted mortgage scheme sector. Given this background and after consulting experts in the mortgage scheme sector, we are proposing to apply the 'if not, why not' approach to this sector.

4 We have prepared a draft regulatory guide (the draft guide) which sets out our proposals for disclosure benchmarks and advertising standards for mortgage schemes: see Appendix 2 to this paper. While the disclosure model we propose to adopt is the same as for debentures, the different benchmarks for unlisted mortgage schemes reflect the different risk profile of these products and the different legal structures and rights.

5 We propose that the benchmarks and disclosure requirements apply to unlisted mortgage schemes that raise funds from retail investors. We propose that the advertising standards apply to all mortgage schemes (whether listed or unlisted) that raise funds from retail investors.

6 Our proposals are relevant to:

(a) responsible entities of unlisted mortgage schemes in which retail investors invest—in disclosing to retail investors against the proposed benchmarks;

(b) responsible entities of all mortgage schemes—in meeting standards when advertising to retail investors;

(c) compliance plans, compliance committees and compliance plan auditors of mortgage schemes—in ensuring that responsible entities comply with their disclosure and advertising obligations;

(d) valuers—in assessing the quality of the mortgage scheme's loan assets; and

(e) research houses that provide investment ratings for mortgage schemes.

7 This consultation paper asks questions about specific matters raised by the draft guide. However, we would also be interested in any other general comments you have on the draft guide.

Investment in the mortgage scheme sector

8 The Australian Bureau of Statistics (ABS) compiles data for the Australian managed funds sector comprising funds held by superannuation funds, public unit trusts, life insurance offices, friendly societies, common funds, and cash management trusts.

9 These funds invest in a wide spectrum of asset classes ranging in risk and return profile and liquidity.

10 The analysis in Figure 1 below shows that:

(a) managed funds with investments in equities and unit trusts account for about $763 billion (or 49%) of total unconsolidated funds;

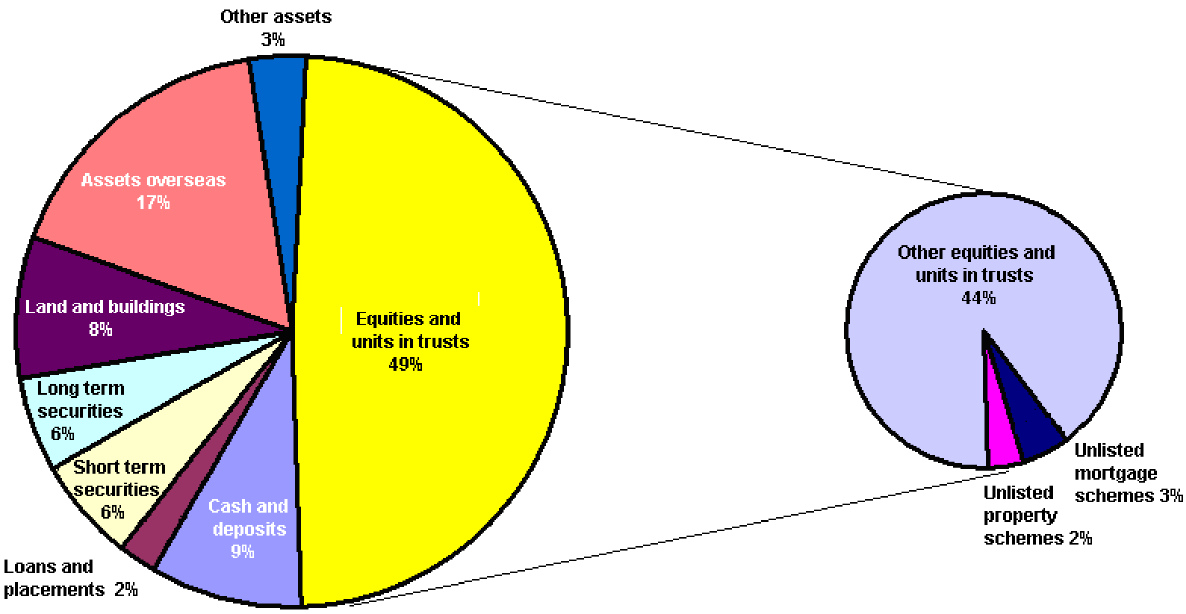
(b) of that $763 billion, a significant value ($74 billion) but relatively small percentage (5%) is invested in unlisted securitised property related investments, being unlisted mortgage schemes and unlisted property schemes.

(c) ASIC has analysed and profiled the population of registered managed investment schemes and has supplemented the ABS data with this analysis to reflect the following managed funds investments:

(i) $42 billion (or 3%) invested in over 200 unlisted mortgage funds; and

(ii) $32 billion (or 2%) invested in over 300 unlisted property funds.

Figure 1: Managed funds $1.566 trillion unconsolidated (100%)



Sources: ABS, ASIC

B Benchmarks for unlisted mortgage schemes

Key points

ASIC proposes that responsible entities of unlisted mortgage schemes in which retail investors invest should address certain key benchmarks in their Product Disclosure Statements (PDSs) and ongoing disclosures: see Section C of the draft guide.

What would the benchmarks apply to?

Proposal

B1 We propose to define a 'mortgage scheme' as a managed investment scheme that has or is likely to have at least 50% of its non-cash assets invested in mortgage loans and/or other unlisted mortgage schemes: see RG 000.11.

Note: Mortgage loans are loans secured by a mortgage over real property (including residential, commercial, industrial or retail property or vacant land).

B2 We propose that the benchmarks apply to unlisted registered mortgage schemes in which retail investors may invest directly or indirectly (e.g. through an investor directed portfolio service): see RG 000.12.

Your feedback

B2Q1 Do you agree with our proposed definition of 'mortgage scheme'?

B2Q2 Are there any other schemes to which the benchmarks should apply?

What are the proposed benchmarks?

11 The 8 benchmarks set out in the draft guide reflect information that we consider is key to enable retail investors to analyse the risks of unlisted mortgage schemes. The proposed benchmarks reflect our experience and consultation with industry experts about appropriate benchmarks for retail investors in unlisted mortgage schemes. As mentioned above, the proposed benchmarks are an indication of the approach we may take and are not our final policy.

Proposal

B3 There should be clear benchmarks for 8 significant areas of potential risk for retail investors in unlisted mortgage schemes:

(a) **Benchmark 1**: Liquidity (see RG 000.37–RG 000.45)

(b) **Benchmark 2**: Scheme borrowing (see RG 000.46–RG 000.50)

(c) **Benchmark 3**: Portfolio diversification (see RG 000.51–RG 000.58)

(d) **Benchmark 4**: Related party transactions (see RG 000.59–RG 000.61)

(e) **Benchmark 5**: Valuation policy (see RG 000.62–RG 000.67)

(f) **Benchmark 6**: Lending principles—loan-to-valuation ratios (see RG 000.68–RG 000.72)

(g) **Benchmark 7**: Distribution practices (see RG 000.73–RG 000.77)

(h) **Benchmark 8**: Withdrawal arrangements (see RG 000.78–RG 000.83)

Your feedback

B3Q1 Have we identified the relevant benchmarks? What is missing and/or have we included anything that is not relevant?

B3Q2 Are there more effective ways of dealing with the risks faced by retail investors other than by benchmarks? Please give details.

B3Q3 We propose that the following benchmarks not apply to contributory mortgage schemes:

(a) the portfolio diversification benchmark; and

(b) certain aspects of the valuation benchmark.

Should any of the other benchmarks (e.g. the liquidity benchmark) also not apply to these schemes? Alternatively, would it be preferable for contributory mortgage schemes to disclose against all the benchmarks?

B3Q4 Are there any other types of mortgage schemes for which some or all of the benchmarks are inappropriate?

Liquidity

B3Q5 Should responsible entities be required to hold a minimum amount of assets as liquid assets (e.g. 10%)? If so, what proportion should be liquid assets?

B3Q6 We have proposed that undrawn amounts under credit facilities be excluded when determining scheme liquidity. Do you agree?

B3Q7 We have proposed that a reasonable estimate of new investment inflows may be included when determining scheme liquidity. Do you agree?

Your feedback (continued)

Scheme borrowing

B3Q8 Do you think we should set a maximum limit in this benchmark beyond which schemes should not borrow against the assets of the fund?

B3Q9 Our benchmark on scheme borrowing does not specify that responsible entities should disclose probable or likely breaches of loan covenants. Would information on these prospective breaches be helpful for retail investors? Would providing the information be practical for responsible entities?

Lending principles—loan-to-valuation ratios

B3Q10 Do you think the ratios we propose are appropriate?

B3Q11 Are there different types of lending where different ratios may be appropriate?

Distribution practices

B3Q12 Is it feasible for responsible entities to disclose whether distributions sourced other than from income are sustainable?

Withdrawal arrangements

B3Q13 Where an investment will be 'rolled over' automatically unless the investor makes a positive decision to withdraw their funds, should responsible entities provide updated disclosure to the investor before the rollover occurs?

Explanation

12 The reasons why we believe it is important for responsible entities to disclose against the proposed benchmarks are explained in detail under each of the proposed benchmarks in Section C of the draft guide.

13 The Investment and Financial Services Association Limited (IFSA) has recently released a standard for disclosure in the mortgage trust sector, which covers some of the benchmarks proposed in our draft guide. Table 1 sets out the key differences between our proposed benchmarks and IFSA's standard. Appendix 1 contains a summary of the key requirements of ASIC's proposed benchmarks and IFSA's standard.

Note: See IFSA Standard No. 18.00—Best Practice Guidance for Disclosure in the Mortgage Trust Sector (July 2008).

Table 1: Key differences between ASIC's proposed benchmarks and IFSA's standard

ASIC's proposed benchmarks	Key differences compared to IFSA's standard
1 Liquidity	No significant difference.
2 Scheme borrowing	ASIC proposes additional requirements about disclosing loan covenants that are in breach and whether the interests of lenders rank ahead of an investor's interest.
3 Portfolio diversification	No significant difference. IFSA proposes disclosure of the use of derivatives and loan origination fees.
4 Related party transactions	No significant difference.
5 Valuation policy	No significant difference.
6 Lending principles	ASIC proposes maximum loan-to-valuation ratios and additional requirements about staged lending for property development.
7 Distribution practices	ASIC proposes disclosure requirements about the sourcing and sustainability of distributions and situations where lower distributions than promoted returns may be payable.
8 Withdrawal arrangements	ASIC proposes additional disclosure requirements about maximum withdrawal periods, ability to meet promoted withdrawal periods and promoted fixed redemptions, and the approach to rollovers.

C Disclosing against the benchmarks

Key points

ASIC proposes that responsible entities of unlisted mortgage schemes should address the benchmarks on an 'if not, why not' basis in disclosures to retail investors from 31 October 2008: see Section D of the draft guide.

ASIC proposes that responsible entities of existing unlisted mortgage schemes should provide updated disclosure against the benchmarks for existing investors by 31 October 2008: see Section D of the draft guide.

'If not, why not' approach

14 The 'if not, why not' approach we are proposing is similar to our approach for unlisted debentures. 'Why not' means explaining how a responsible entity deals with the issue underlying the benchmark.

15 We are proposing to apply this approach to:

(a) upfront disclosures in the PDS; and

(b) ongoing disclosures.

Upfront disclosure

Proposal

C1 A PDS for an unlisted mortgage scheme should address each of the benchmarks in Section C of the draft guide on an 'if not, why not' basis and either:

(a) state that the mortgage scheme meets the benchmark; or

(b) state that the mortgage scheme does not meet the benchmark **and** explain how and why the responsible entity deals with the principle underlying the benchmark in another way: see RG 000.84.

Your feedback

C1Q1 Are there practical problems with expecting this disclosure in PDSs? If so, what alternative would ensure investors are adequately informed?

C1Q2 Do you agree with our approach to the operation of the disclosure requirements?

Ongoing disclosure

Proposal

C2 Where there have been any material changes to the responsible entity's performance against the benchmarks, including against the responsible entity's alternative approach to meeting the benchmarks, responsible entities should explain this in ongoing disclosures. We consider that best practice is for responsible entities to give information directly to members or make it easily accessible (e.g. by updates on the scheme's website): see Table 5 of the draft guide.

In addition, periodic statements under s1017D should update the scheme's performance against the benchmarks (if this has not previously been notified to investors): see Table 5 of the draft guide.

Responsible entities should also consider whether it would help investors if they were given more frequent updates of the scheme's performance against the benchmarks. We recommend that responsible entities update investors at least every 6 months: see Table 5 of the draft guide.

Your feedback

C2Q1 Are there practical problems with expecting responsible entities to disclose against the benchmarks on an ongoing basis? If so, what would ensure that investors are adequately informed about the ongoing performance of the mortgage scheme?

When you need to disclose against the benchmarks

Proposal

C3 We propose 31 October 2008 as the commencement date for the 'if not, why not' approach to disclosing against the benchmarks for all new PDSs and all ongoing disclosures for new and existing mortgage schemes: see Table 5 of the draft guide.

C4 We propose that by 31 October 2008, responsible entities of existing mortgage schemes should provide updated disclosure for existing investors that addresses each of the benchmarks on an 'if not, why not' basis: see Table 5 of the draft guide.

Your feedback

C4Q1 Do you agree with the proposed timetable for implementation of the benchmark approach for mortgage schemes?

D Advertising standards for all mortgage schemes

Key points

ASIC proposes that responsible entities should adhere to clear standards in advertising for mortgage schemes: see Section E of the draft guide.

We believe that these advertising standards apply to all mortgage schemes (i.e. both listed and unlisted) because the risk to investors of misleading advertisements is the same.

Proposal

D1 We propose that:

(a) advertising by responsible entities should support investor understanding of any disclosures against the benchmarks in Section C of the draft guide and not convey messages inconsistent with them; and

(b) advertisements for all mortgage schemes (whether listed or unlisted) should comply with the advertising standards in Section E of the draft guide from the date of publication of the regulatory guide: see Section E of the draft guide.

Your feedback

D1Q1 Are there any issues with our proposed timing?

D1Q2 Have we identified the relevant issues on advertising? What is missing? Is anything not relevant?

D1Q3 Will the proposed advertising standards cause any practical difficulties for your business? Please give details.

D1Q4 Can you suggest other more effective ways of dealing with advertising issues?

Explanation

16 Experience suggests that retail investors place particular emphasis on the information and impressions given in advertisements. Advertisements do not always give a realistic impression of mortgage schemes, their features and risks. It is particularly problematic when advertisements give messages about a product that are inconsistent with the risks described in a complying PDS.

17 We have a broad concept of advertising in mind here, including comment and promotion of mortgage schemes in media programs or publications (generally know as ‘advertorials’) and statements about mortgage schemes published by responsible entities on their websites (excluding statements in a PDS).

E Compliance plans, compliance committees and compliance plan auditors

Key points

ASIC proposes that compliance plans, compliance committees and compliance plan auditors should actively support:

- the disclosure benchmarks (for unlisted mortgage schemes); and
- the advertising standards (for all mortgage schemes).

See Section F of the draft guide.

18 Mortgage schemes must have compliance plans that set out adequate measures the responsible entity is to apply and follow to ensure compliance with the Corporations Act and the scheme's constitution: Pt 5C.4.

19 Where less than half of the responsible entity's directors are external directors, the mortgage scheme must have a compliance committee: s601JA. The compliance committee must monitor and report on breaches of the law or scheme's constitution and regularly assess the adequacy of compliance plans.

20 The compliance plan auditor must report on whether the responsible entity has complied with the compliance plan and whether the plan is adequate.

21 The draft guide focuses on improved disclosure for retail investors in mortgage schemes. We are therefore also focussing on how compliance plans, compliance committees and compliance plan auditors can ensure there is adequate upfront and ongoing disclosure for retail investors. This is consistent with the requirements of Pt 5C.4 and the general approach of our policy in Regulatory Guide 132 *Managed investments: Compliance plans* (RG 132) that compliance plans should ensure that members are told all information that is necessary for them to make decisions about their holdings: RG 132.12(e).

Proposal

E1 Compliance plans should contain adequate procedures to ensure that responsible entities comply with their:

(a) upfront and ongoing disclosure obligations, including disclosure against the benchmarks (for unlisted mortgage schemes); and

(b) advertising obligations (for all mortgage schemes).

We do not expect that responsible entities will necessarily need to change their compliance plans to deal expressly with these disclosure and advertising obligations.

E2 We expect compliance committees and compliance plan auditors for mortgage schemes to be aware of the disclosure and advertising requirements identified in the draft guide. We also expect compliance committees and compliance plan auditors to have regard to these requirements in carrying out their duties (including when assessing whether compliance plans are adequate).

Your feedback

E2Q1 Will compliance plans need to be modified to specifically address the benchmarks and advertising standards or are existing compliance plans generally satisfactory to address these?

E2Q2 Are there any practical problems with the proposed role for compliance committees and compliance plan auditors? If so, what would ensure investors are adequately protected?

E2Q3 What impact would our proposals have on costs for compliance committees and compliance plan auditors, and how might this affect responsible entities and investors? Please give details.

E2Q4 Should we also require auditors of financial reports to audit:

(a) how the responsible entity has performed against the benchmarks or any alternative approach to the benchmarks; and/or

(b) for the purposes of the responsible entity's performance against Benchmark 1, the responsible entity's cash flow projections and minimum cash holding?

F Investment ratings

Key points

Investment ratings can be useful for retail investors in mortgage schemes. To be effective they need to be properly explained and not create a misleading impression about the scheme: see RG 000.120–RG 000.122.

22 Some retail investors and their financial advisers use investment ratings as a source of information when deciding whether to invest in mortgage schemes. Investment ratings can assist retail investors where they are:

(a) properly explained; and

(b) prepared by a person who has the appropriate level of expertise in assessing mortgage schemes.

23 However, we have some concerns about the use of investment ratings for mortgage schemes, including:

(a) how well investment ratings are understood by retail investors and

(b) the comparability of investment ratings issued by different research houses.

24 Research houses use different methodologies to derive their investment ratings. For example, some research houses and investment ratings focus on publicly available quantitative information (e.g. risk adjusted historical return), while others make use of more qualitative information about the scheme and its management (often including detailed questionnaires, asset level review, and management interviews). There is also a practice of expressing ratings differently. For example, some research houses express their ratings in a number of stars or other symbols, while others describe the rating in words such as ‘recommended’ or a combination of both.

25 Interests in a mortgage scheme are an equity product and credit ratings are not available for those interests. In contrast, debentures are a debt product for which a credit rating can be obtained. Advertisements for debentures should not make any reference to investment ratings of the debenture or the issuer: see RG 156.10–RG 156.12. Given the different nature of interests in mortgage schemes and debentures, we are proposing to permit advertisements for mortgage schemes to refer to investment ratings if certain conditions are satisfied: see RG 000.120–RG 000.122.

26 We are also considering how investment ratings are used by investors as part of a separate review of the regulation of ratings agencies and research houses

that was initiated by the Minister for Superannuation and Corporate Law in May 2008.

Proposal

F1 References to investment ratings in mortgage scheme advertising need to be properly explained to retail investors and not create a misleading impression about the scheme: RG 000.120–RG 000.122.

Your feedback

F1Q1 Are investment ratings useful to retail investors in mortgage schemes? Are investment ratings being properly explained to retail investors?

F1Q2 What are the advantages (for issuers, advisers, distribution channels, and retail investors) of the use of investment ratings and research houses for mortgage schemes?

F1Q3 What difficulties (if any) do retail investors face in interpreting investment ratings for mortgage schemes?

F1Q4 How comparable are investment ratings for mortgage schemes that are prepared by different research houses?

F1Q5 Is there a risk that retail investors may place undue weight on an investment rating when making their investment decision?

F1Q6 Where an unlisted mortgage scheme advertises a rate of return, is there a risk that retail investors may consider an investment rating for the scheme to be a credit rating?

F1Q7 Are the requirements about the use of investment ratings in advertisements appropriate? Should we impose any other conditions on the use of investment ratings for mortgage schemes (e.g. prohibiting the use of investment ratings in advertisements or requiring warnings to accompany investment ratings)?

G Regulatory and financial impact

27 In developing the proposals in the draft guide, 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) preventing the mis-selling of interest in mortgage schemes; and

(b) not unduly interfering with the market and flexibility of the public fundraising process.

28 Before settling on a final policy, we will comply with the requirements of the Office of Best Practice Regulation (OBPR) by:

(a) considering all feasible options;

(b) if regulatory options are under consideration, undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy;

(c) if our proposed option has more than low impact on business and individuals or the economy, consulting with OBPR to determine the appropriate level of regulatory analysis; and

(d) conducting the appropriate level of regulatory analysis, that is, complete a Business Cost Calculator report (BCC report) and/or a Regulation Impact Statement (RIS).

29 All BCC reports and RISs are submitted to the OBPR for approval before we make any final decision. Without an approved BCC Report and/or RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

30 To ensure that we are in a position to properly complete any required BCC report or RIS, we ask you to provide us with 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.

See ‘The consultation process’ p. 4.

Appendix 1: Benchmark comparison

Table 2: Summary of ASIC's proposed benchmarks and IFSA's standard

Benchmark	ASIC's proposed benchmark	IFSA's standard
Liquidity	Responsible entities should: • have cash flow estimates for the next 3 months • ensure that sufficient cash or cash equivalents exist to meet projected cash needs over the next 3 months • not include undrawn credit facilities for the purpose of this benchmark • disclose their policy on balancing the maturity of their assets and liabilities.	Responsible entities should: • have cash flow estimates for the next 3 months • ensure that sufficient cash or cash equivalents exist to meet projected cash needs over the next 3 months • disclose their policy on balancing the maturity of their assets and liabilities • disclose liquid assets and details of any lines of credit in relation to meeting buy-back obligations.
Scheme borrowing	Where a scheme borrows funds the responsible entity should disclose: • details of current borrowings • whether interests of lenders/creditors rank ahead of investors' interests • the purpose for the borrowed funds • prospects of refinancing credit facilities which mature within 12 months • breaches of loan covenant information that investors would reasonably require.	Responsible entities should disclose: • provisions in constitutions regarding borrowing • the purpose for the borrowed funds.
Portfolio diversification	Responsible entities should disclose: • the number of loans, class of activity and geographic region • the nature of the security for the loans • monies lent to the largest borrower and the 10 largest borrowers • details about approved loans where the funds have yet to be advanced • loan maturity profiles in periods of not more than 1 year • proportion of loans in default or arrears • loan-to-valuation ratios • interest rates on loans • loans where interest has been capitalised • any non-loan assets of the scheme including the value of such assets • their policy on how scheme funds will be lent • their policy on investing in unlisted mortgage schemes.	Responsible entities should disclose: • the number of loans, class of activity and geographic region • the nature of the security for the loans • the type of property securing the loan • their policy on composition of mortgage portfolio • loan maturity profiles in periods of 1 year, but every 3 months in the 1st year • approved loans where the funds have yet to be advanced • loan-to-valuation ratios • interest rates on loans • proportion of loans in default or arrears • qualifications or restrictions in constitutions relating to mortgage loans • whether loans require mortgage insurance • method of determining borrowers' capacity to service loan • the use of derivatives • sale or purchase of mortgage loans in the past year where a benefit is received.

Benchmark	ASIC's proposed benchmark	IFSA's standard
Related party transactions	Responsible entities should disclose: • details of related party transactions • their policy on entering into and monitoring related party transactions.	Responsible entities should disclose: • details of related party transactions • their policy in relation to related party transactions.
Valuation policy	Responsible entities should adopt the following approach: • value development property on an 'as if complete' basis and all property on an 'as is' basis • have a policy on how often they obtain valuations • establish a panel of valuers and ensure that no one valuer conducts more than 1/3 of the valuation work • disclose valuations for property securing loans that account for 5% or more of the scheme's loan book • valuations to be prepared by independent registered valuers who warrant that their valuations comply with industry standards.	Responsible entities should adopt the following approach: • value property on an 'as is' basis • for development property, disclose on what basis the valuation has been undertaken • establish a panel of valuers and ensure that no one valuer conducts more than 1/3 of the valuation work • valuations to be prepared by independent registered valuers • disclose how valuations are derived • where lending is on an 'as if complete' basis, disclose on completion LVR and present value LVR • disclose their policy on revaluing mortgage property.
Lending principles	Responsible entities should maintain the following LVRs: • 70%—for property development • 80%—for all other cases. For property development, the advancement of funds should match the progress of development .	Responsible entities should disclose: • the upper limit of the LVR • their loan origination fees.
Distribution policy	Responsible entities should disclose: • the expected source for distributions • whether this differs from previous distribution sources. Where distributions are not sourced from income, disclose why. Where particular returns are promoted, disclose where a lower return may be paid.	No equivalent benchmark
Withdrawal arrangements	Responsible entities should disclose whether investors can withdrawal from the scheme. Where investors can withdraw, the responsible entity should disclose: • the maximum withdrawal period allowed under the constitution • significant risks that may impact on the ability of investors to withdraw • the approach to rollovers Where fixed unit price redemptions are promoted, disclose where lower amounts may be payable.	Responsible entities should disclose the arrangements made to meet buy-back obligations.

ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 000

Mortgage schemes—improving disclosure for retail investors

July 2008

About this guide

This is a guide for responsible entities, compliance committees, compliance plan auditors, valuers, publishers and others involved with the issue or advertising of interests in mortgage schemes.

It sets out guidelines for improved disclosure to retail investors to help them understand and assess these schemes, while maintaining the flexibility of the public fundraising process.

It also sets out the standards we expect responsible entities and publishers to meet when advertising mortgage schemes that are offered to retail investors.

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 version was issued on 8 July 2008 and is based on legislation and regulations as at 8 July 2008.

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

A Overview

Key points

ASIC has developed 8 benchmarks for unlisted mortgage schemes that can help retail investors understand the risks, assess the rewards being offered and decide whether these investments are suitable for them: see RG 000.1–RG 000.5.

Responsible entities of unlisted mortgage schemes in which retail investors invest should address the benchmarks in their disclosures on an 'if not, why not' basis: see RG 000.6–RG 000.7.

ASIC has also set standards for advertising of all mortgage schemes (whether listed or unlisted) to retail investors: see RG 000.8–RG 000.10.

Those involved with mortgage schemes (e.g. compliance committees, compliance plan auditors and valuers) should use the benchmarks and the 'if not, why not' explanations in carrying out their responsibilities: see RG 000.14.

Benchmarks for unlisted mortgage schemes

RG 000.1 Since mid-2007, Australia has experienced debt market turbulence flowing from the US sub-prime crisis, together with successive interest rate increases and a cyclical softening in property markets. Some mortgage schemes have experienced financial stress under these economic conditions, evidenced by a decrease in fund inflows and extensions of withdrawal periods or suspensions of withdrawals.

RG 000.2 In this context, ASIC considers that the requirement to provide retail investors in mortgage schemes with the information they need to make an investment decision requires, at a minimum, disclosure against key benchmarks.

RG 000.3 ASIC has developed 8 benchmarks that apply to all unlisted mortgage schemes in which retail investors invest: see Table 1 and Section C of this guide. We expect the benchmarks to be followed (as applicable) and if not followed, explained on an 'if not, why not' basis. We also expect any advertising to support the use of these benchmarks: see Section E.

RG 000.4 Failing to meet one or more of these benchmarks does not mean that a particular mortgage scheme is necessarily a poor investment; however, additional disclosure to investors will be needed to address that benchmark on an 'if not, why not' basis so that investors can assess its impact on their investment decision.

RG 000.5 The benchmark approach to disclosure for unlisted mortgage schemes is an extension of the approach we took for debentures in Regulatory Guide 69 *Debentures—improving disclosure for retail investors* (RG 69). We consider that this model is also suitable for unlisted mortgage schemes because:

(a) some features and risks of mortgage schemes are similar to features and risks of mortgage debentures (e.g. liquidity management and loan portfolio diversification are important considerations for both products);

(b) the underlying assets of mortgage schemes are usually relatively illiquid, which can impact on an investor's ability to withdraw from the scheme; and

(c) being unlisted means that there is no liquid secondary market on which an investor can sell an investment.

Table 1: Benchmarks for unlisted mortgage schemes in which retail investors invest

1 Liquidity	Benchmark 1 addresses the scheme's ability to satisfy withdrawal requests and other operational commitments.
2 Scheme borrowing	Benchmark 2 addresses the scheme's policy on borrowing.
3 Portfolio diversification (pooled mortgage schemes only)	Benchmark 3 addresses the scheme's lending practices and portfolio risk.
4 Related party transactions	Benchmark 4 addresses the risks associated with related party lending, investments and transactions.
5 Valuation policy	Benchmarks 5 and 6 address the scheme's property-related lending and valuation practices.
6 Lending principles—loan-to-valuation ratios	
7 Distribution practices	Benchmark 7 addresses the transparency of the scheme's distribution practices.
8 Withdrawal arrangements	Benchmark 8 addresses the transparency of the responsible entity's approach to withdrawals of investments.

Disclosure against the benchmarks—'If not, why not'

RG 000.6 Responsible entities of unlisted mortgage schemes in which retail investors invest should address the benchmarks in their disclosures on an 'if not, why not' basis: see Section D of this guide. This means stating that the scheme either:

(a) meets the benchmark; or

(b) does not meet the benchmark *and* explaining how and why the responsible entity deals with the business factors or issues underlying the benchmark in another way.

RG 000.7 Disclosure against the benchmarks should be:

(a) addressed upfront in the Product Disclosure Statement (PDS);

(b) updated in ongoing disclosures as material changes occur (e.g. in a supplementary PDS or continuous disclosure notice); and

(c) supported in, and not undermined by, advertising material.

Responsible entities may also choose to update disclosures against the benchmarks in other materials (e.g. monthly or quarterly fund updates).

Advertising standards for mortgage schemes

RG 000.8 Experience indicates that retail investors who are thinking about investing place particular emphasis on the information and impressions given in advertisements. Some of the advertisements we have observed for mortgage schemes have not given a realistic impression of the scheme, its features and risks.

Note: References to 'advertisements' in this guide should be read broadly. They include comment on and promotion of mortgage schemes in media programs or publications (generally known as 'advertorials') and statements about mortgage schemes published by responsible entities on their websites. They do not, however, include statements in a PDS.

RG 000.9 To promote investor understanding of mortgage schemes and minimise the risk of mis-selling, ASIC has set standards for responsible entities when advertising their mortgage schemes: see Table 2 and Section E of this guide. These standards apply to all mortgage schemes (whether listed or unlisted) that are offered to retail investors.

RG 000.10 While the primary responsibility for advertising material rests with the organisation placing the advertisement, under general law the publisher or other media conduit may also have some responsibility for its content. Therefore, we expect publishers and the media to support these standards when accepting advertisements for mortgage schemes.

Table 2: Advertising standards for mortgage schemes (whether listed or unlisted)

Area	Summary of standard
Repayment of principal investment	To avoid common misconceptions about the risk profile of mortgage schemes, all advertisements for mortgage schemes that are offered to retail investors should include a prominent statement to the effect that investors risk losing some or all of their principal investment.
Returns on investment	Advertisements for mortgage schemes should only quote returns if the return is accompanied by prominent disclosure that there is a risk that the investment may achieve lower than expected returns. Advertisements for mortgage schemes should only quote investment ratings if the rating is properly explained and does not create a misleading impression about the scheme.

Area	Summary of standard
Comparisons with bank deposits and 'risk free' suggestions	Advertisements for a mortgage scheme should state that the mortgage scheme is not a bank deposit. They should *not* suggest that: • the mortgage scheme is, or compares favourably to, a bank deposit; or • there is no or little risk of the investor losing their principal or not being repaid.
Withdrawal periods, withdrawal rights and investment periods	Advertisements for mortgage schemes that refer to withdrawal periods, withdrawal rights or investment periods should include details of any restrictions on withdrawal that might apply.
Fees	Advertisements for mortgage schemes that state the amount of a fee (or that a type of fee is not payable) should include details of any circumstances in which a higher fee applies (or in which the fee is payable).
Suitability statements	Advertisements for mortgage schemes should not state or imply that the investment is suitable for a particular class of investor.
Consistency with PDS disclosure	Statements in advertisements for mortgage schemes should be consistent with the corresponding disclosures on that subject matter in the PDS.
Telephone inquiries	Statements made in response to inquiries are subject to the same regulation regarding misleading and deceptive conduct as the advertisements.

Who does this guide apply to?

RG 000.11 For the purposes of this guide, a 'mortgage scheme' is a managed investment scheme that has or that is likely to have at least 50% of its non-cash assets invested in mortgage loans and/or unlisted mortgage schemes. Mortgage loans are loans secured by a mortgage over real property (including residential, commercial, industrial or retail property or vacant land).

RG 000.12 We expect responsible entities of unlisted registered mortgage schemes in which retail investors invest directly or indirectly (e.g. through an investor directed portfolio service) to follow the disclosure benchmarks as discussed in Sections C and D of this guide.

RG 000.13 We expect responsible entities of both listed and unlisted registered mortgage schemes to follow the advertising standards in Section E.

RG 000.14 We expect other parties involved with issues of interests in unlisted registered mortgage schemes or advertisements for registered mortgage schemes generally to support the principles in this guide. This includes compliance committees, compliance plan auditors, valuers, publishers and media.

RG 000.15 For example, we expect compliance plans for mortgage schemes to set out adequate measures to ensure compliance with the disclosure and advertising standards in this guide: see Section F.

What is the timing?

RG 000.16 For offers of interests in new unlisted mortgage schemes, responsible entities must disclose against the benchmarks in their PDS from 31 October 2008. We also expect them to refer to benchmarks in their ongoing disclosure from that time.

RG 000.17 For existing unlisted mortgage schemes, responsible entities have until 31 October 2008 to address the benchmarks on an 'if not, why not' basis in updated disclosure that is brought directly to the attention of their existing investors. We also expect responsible entities of existing mortgage schemes to refer to the benchmarks in any new PDS and in their ongoing disclosures from 31 October 2008 on an 'if not, why not' basis.

RG 000.18 We will review updated investor disclosures for each responsible entity in this industry sector in the period from 31 October 2008 to 31 December 2008 to check that this benchmarking information is adequately disclosed to investors on an 'if not, why not' basis.

RG 000.19 During this period we will also:

(a) work with responsible entities to ensure that the benchmarks and our disclosure expectations are understood;

(b) discuss any concerns we have with a responsible entity's disclosure with them and, where necessary, require additional disclosure (e.g. about the practical impact of not following a particular benchmark and the associated risks for investors);

(c) discuss any concerns we have about the financial position and performance of a mortgage scheme with the responsible entity; and

(d) conduct surveillance visits as needed to reinforce our disclosure expectations.

RG 000.20 For all listed and unlisted mortgage schemes, responsible entities must comply with the advertising standards from the publication date of the final version of this guide.

Table 3: Timetable for implementing improved disclosure

From publication date of final guide	Responsible entities for all listed and unlisted mortgage schemes comply with advertising standards.
By 31 October 2008	Responsible entities for existing mortgage schemes report against benchmarks to existing investors.
From 31 October 2008	New fundraising documents for new and existing mortgage schemes comply with 'if not, why not' benchmarks.
31 October 2008–31 December 2008	ASIC reviews fundraising documents and other disclosure against the 'if not, why not' approach.
January–March 2009	ASIC issues public report on the results of the new approach.

Underlying principles

RG 000.21 The disclosure framework in the Corporations Act requires responsible entities of mortgage schemes to:

(a) disclose upfront to investors all the information they reasonably need to know in order to make a decision as a retail client to acquire an interest in the scheme; and

(b) provide ongoing disclosure about material matters to help retail investors monitor whether their expectations are being met.

RG 000.22 Disclosure is not designed to stop retail investors from taking investment risks, but to help them understand the risks involved in any particular investment or type of investment. This enables them to make an informed decision about whether the potential reward (the return on their investment) matches the level of risk involved, and whether they are prepared to take on that risk.

RG 000.23 We believe that our approach balances:

(a) the need to improve disclosure to allow investors to make better informed decisions; and

(b) the desirability of not unduly interfering with this market as a market for raising capital.

Note: The need to strike an appropriate balance between protecting investors' interests and allowing markets to operate freely is part of ASIC's mandate under the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

RG 000.24 This approach should lead to more comparable disclosure for mortgage schemes, helping investors to compare investments in this sector.

RG 000.25 Our approach cannot prevent investments failing, nor ensure that they perform to investors' expectations. However, better disclosure can help investors make better risk–reward decisions.

RG 000.26 Our approach should not result in longer disclosures. Recent experience shows that investors need better quality and relevant disclosure, presented in a way best suited to investor understanding.

RG 000.27 We have also set standards for responsible entities when advertising mortgage schemes: see Section E. These standards seek to reduce the risk that advertisements will give retail investors messages about mortgage schemes that are inconsistent with disclosure in a complying PDS.

B The unlisted mortgage scheme sector

Key points

Some features of unlisted mortgage schemes can create risks for investors. Clear benchmarks can help investors to make better-informed decisions about these products.

Business models of mortgage schemes

RG 000.28 A mortgage scheme operates on the basis that:

(a) the scheme raises funds by issuing interests to investors. These funds are either pooled and lent by the scheme to various borrowers (pooled schemes) or lent in relation to a specific property (contributory schemes). In both pooled and contributory schemes, loans are secured by mortgages over real property and security may be a first or subsequent mortgage;

(b) for pooled schemes, investors do not have an interest in a particular mortgage loan, but have an interest in scheme property as a whole;

(c) the return to investors is generally generated by interest payments made by the borrowers to the scheme;

(d) investments are either for a fixed term or are able to be withdrawn following a withdrawal request; and

(e) the value of an investor's investment may be subject to change depending on the asset position of the scheme.

RG 000.29 Some mortgage schemes may lend funds for construction or property development. For these schemes, the skills and experience of the responsible entity in assessing these activities and selecting appropriate loans are particularly important to the performance of the scheme.

RG 000.30 Some schemes promote that they can provide investors with a level of capital security by committing to pay investors back their initial investment at the end of their investment term. Other schemes promote fixed rates of return.

RG 000.31 Some schemes may lend funds to borrowers and 'capitalise' the expected interest payments. This means that the scheme may not be receiving actual cash payments from the borrower over the course of the loan and instead receive the capital and accumulated interest payments at the end of the loan term.

RG 000.32 Many schemes promote that withdrawal requests will generally be satisfied within a relatively short period.

Risks to investors

RG 000.33 Past experience and our recent analysis of the mortgage scheme market suggests that features of the operations of some mortgage schemes can hold particular risks for investors. These key features and risks are identified in Table 4.

RG 000.34 These features are not present in every unlisted mortgage scheme that is offered to retail investors. The investment risks described will vary from scheme to scheme and from business model to business model. However, disclosure about these features and risks, including to what extent they are present in a given offering, is relevant for a broad range of schemes.

RG 000.35 The disclosure benchmarks in Section C address these features and risks, so that investors can make better-informed decisions about whether a mortgage scheme is a suitable investment for them.

RG 000.36 We have excluded listed mortgage schemes for the purposes of the disclosure benchmarks in Section C because:

(a) being listed means that there is a secondary market on which an investor can sell their investment;

(b) the market supervisor will assess and, if appropriate, admit the interests in the scheme to trading; and

(c) the market supervisor will supervise the scheme's ongoing compliance with any listing rules, in particular, a continuous disclosure regime.

Note: The advertising standards in Section E apply to all mortgage schemes, whether listed or unlisted.

Table 4: Key risk features of mortgage schemes

Risk feature	Description	What this means
Liquidity	The liquidity of the scheme is key to its ability to meet its representations about the ability of investors to withdraw from the scheme and its other ongoing commitments.	Liquidity may be at risk because of a mismatch between when the responsible entity represents that it can meet withdrawal requests and cash flows from the underlying businesses or assets to which funds have been lent. Liquidity is frequently heavily dependent on continuing inflows from new investors, borrowings or 'rollovers' by existing investors as the underlying assets of the scheme may not be easily realised within a short period of time.
Scheme borrowing	Some schemes borrow against the assets of the scheme to fund distributions, redemption requests or scheme operations generally.	Where a scheme borrows against the assets of the scheme, investors' interests in the scheme's assets will generally rank behind the lender. Investors in schemes with high borrowings face the risk that distributions will not be made or withdrawals will be suspended so that loan payments can be met. Investors also face the risk that they may lose part or all of their investment where the scheme defaults on these loans.

Risk feature	Description	What this means
Portfolio diversification	The criteria responsible entities use to decide what loans to make are variable and prone to risk, especially where: • loan-to-valuation ratios are often much higher than for traditional lending; and • the loans made may be highly concentrated to particular types of commercial activities, locations or borrowers.	Lack of diversification in the mortgage scheme's loan book may mean that an adverse event affecting one borrower or one type of loan will simultaneously affect the majority of borrowers, and therefore put the overall portfolio at greater risk.
Related party transactions	Some schemes lend, invest scheme funds and transact with associated companies or businesses.	There is an increased risk that these transactions are less likely to be made on arm's length commercial terms and that the responsible entity will not monitor them as robustly as those involving unrelated parties.
Inconsistency in valuations	The valuations schemes rely on are carried out on a variety of bases, with differing assumptions and instructions. These valuations are fundamental to determining the amount the scheme may lend.	If valuations are not prepared properly or by appropriately qualified and experienced valuers, it is difficult to assess the risk exposure associated with a loan. It is also difficult to monitor loan-to-valuation ratios on a continuing basis.
Distribution practices	Some schemes fund distributions out of sources other than income.	Where distributions are not sourced solely from scheme income, there is a risk that these distribution practices may not be sustainable over the long term. This risk may be heightened where a scheme promotes a fixed return on investments.
Withdrawal arrangements	Some mortgage schemes promote a short withdrawal period to attract investors, although the maximum period allowed in the scheme's constitution is much longer.	This creates the risk that investors do not fully appreciate that their right of withdrawal may be refused until a longer period of time has elapsed from the one represented.
Misleading advertising	Advertising used to promote some mortgage schemes helps create unrealistic expectations about their investors' ability to withdraw their investment and the scheme's relative safety.	Even if the PDS highlights risk in an appropriate way, advertising that conveys messages not in line with the regulated disclosure document can undermine the effect of that disclosure.

C Benchmarks for unlisted mortgage schemes

Key points

All responsible entities of unlisted mortgage schemes should address general benchmarks on:

- liquidity (see RG 000.37–RG 000.45);
- scheme borrowing (see RG 000.46-RG 000.50);
- portfolio diversification (see RG 000.51–RG 000.58);
- related party transactions (see RG 000.59–RG 000.61);
- valuation policy (see RG 000.62–RG 000.67);
- lending principles—loan-to-valuation ratios (see RG 000.68–RG 000.72);
- distribution practices (see RG 000.73–RG 000.77); and
- withdrawal arrangements (see RG 000.78-RG 000.83).

Valuers should support the valuation policy benchmark: see RG 000.64.

Benchmark 1: Liquidity

RG 000.37 The responsible entity of a mortgage scheme should:

(a) have cash flow estimates for the scheme for the next 3 months; and

(b) ensure that at all times the scheme has cash or cash equivalents (but not including undrawn amounts under bank overdraft or lending facilities) sufficient to meet its projected cash needs over the next 3 months.

Note 1: In estimating cash flows a responsible entity can take into account a reasonable estimate of investor inflows and outflows based on previous experience. Withdrawals should be determined with reference to the period within which investors would reasonably expect withdrawal requests to be processed, rather than the maximum period within which the responsible entity is able to process withdrawal requests.

Note 2: 'Cash' and 'cash equivalents' have the same meaning as in Australian Accounting Standard AASB 107 'Cash Flow Statements'. Paragraph 9 of AASB 107 defines 'cash' as 'cash on hand and demand deposits' and 'cash equivalents' as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. However, for the purposes of the benchmark, a responsible entity cannot take into account undrawn amounts under bank overdraft or lending facilities.

RG 000.38 Responsible entities should also disclose the policy of the scheme on balancing the maturity of their assets and the maturity of their liabilities. For example, where a scheme has a policy of ensuring that sufficient assets are held in readily realisable investments in order to meet future withdrawal requests, the responsible entity should state this in their PDS and report against this in their ongoing disclosures.

Explanation

RG 000.39 For the purposes of this benchmark, liquidity is the proportion of cash or cash equivalents in a scheme's assets. It is a powerful indicator of the ability of the scheme to meet its short-term commitments. For mortgage schemes it is relative liquidity (i.e. short-term assets relative to short-term liabilities) that we are particularly concerned with.

Note: Liquidity for the purposes of this benchmark is not the same as liquidity for the purposes of Part 5C.6 (which relates to satisfying a statutory test). It is important that any disclosure to investors does not confuse these two concepts.

RG 000.40 Recent experience and the expert advice ASIC received in developing the benchmarks show adequate liquidity is a key feature in the ability of the responsible entities of some mortgage schemes to meet investors' expectations concerning their ability to withdraw from those schemes.

RG 000.41 Mortgage schemes face significant challenges in managing their liquidity. For example, many mortgage schemes are marketed on the basis that withdrawal requests are generally satisfied within a few days even though:

(a) scheme constitutions may allow up to 1 year to satisfy withdrawal requests;

(b) it may take a relatively long period to realise mortgage loans held by mortgage schemes; and

(c) the strength of the market for mortgage loans is likely to vary according to surrounding economic circumstances such as the strength of the property market and the level of mortgage defaults.

RG 000.42 Liquidity management is also important in order for schemes to meet:

(a) investor expectations concerning the payment of distributions;

(b) loan commitments drawn in stages by borrowers;

(c) changes in the scheme's operational needs;

(d) unexpected expenses of the scheme; and

(e) interest on scheme borrowing.

RG 000.43 We envisage responsible entities would need to review their forecast cash flows on an ongoing basis to determine whether they continue to satisfy this benchmark. We would expect responsible entities to take into account their historical experience on investor inflows and outflows in estimating their cash flows. We also expect responsible entities to disclose material assumptions underlying their cash flows (e.g. historical inflow and outflow rate) when reporting against this benchmark.

RG 000.44 We also expect responsible entities to periodically 'stress test' their liquidity assumptions. For example, we would expect responsible entities to consider:

(a) their current PDS and the possibility of an ASIC stop order disrupting their cash flows;

(b) the possibility of a significant increase in the rate of investor withdrawal requests; and

(c) the possibility of a significant reduction in the rate of investor rollovers or new investments.

RG 000.45 We would expect responsible entities to take into account the results of their stress testing in their liquidity planning. In some cases, this may mean they need to increase their cash position: see RG 000.37.

Benchmark 2: Scheme borrowing

RG 000.46 Where a scheme expects to borrow funds or has borrowed funds (whether on or off balance sheet), the responsible entity should disclose:

(a) for each debt that will mature in 5 years or less—the amount owing and the maturity profile in increments of not more than 12 months;

(b) for debts that mature in more than 5 years—the total amount owing;

(c) for each credit facility—the undrawn amount and the maturity profile in increments of no more than 12 months;

(d) whether amounts owing to lenders and other creditors of the scheme rank ahead of an investor's interests in the scheme; and

(e) the purpose for which the funds have or will be borrowed, including whether they will be used to fund distributions or withdrawal amounts.

RG 000.47 Where debts and credit facilities are due to mature within 12 months, the responsible entity should make appropriate disclosure about the prospects of refinancing or possible alternative actions (e.g. sale of assets). Responsible entities should explain any risks associated with their debt and credit facility maturity profile.

RG 000.48 Responsible entities will also need to disclose any information about breaches of loan covenants that is reasonably required by investors. Responsible entities should update investors about the status of any breaches through ongoing disclosure.

Explanation

RG 000.49 Some schemes borrow to finance distributions or the operation of the scheme. It is important that investors are made aware if this is the case and are provided with details of the debts and credit facilities entered into by the scheme. Debts that are due to mature within a relatively short timeframe can be a significant risk factor, especially in periods where credit is more difficult and expensive to obtain. Investors will generally rank behind creditors of a scheme, and responsible entities should disclose whether this is the case.

RG 000.50 Responsible entities should also disclose whether borrowed funds will be used to fund distributions or withdrawal requests since this may indicate that the responsible entity's policy on distributions and withdrawals is not sustainable over the long term. Information about breaches of loan covenants reasonably required by investors is key risk information in upfront and ongoing disclosures.

Benchmark 3: Portfolio diversification

RG 000.51 A responsible entity (other than the responsible entity of a contributory mortgage scheme) should disclose the current nature of the mortgage scheme's investment portfolio, including:

(a) by number and value, loans by class of activity (e.g. development projects, industrial, commercial, retail, specialised property, reverse mortgages);

(b) by number and value, loans by geographic region;

(c) by number and value, what proportion of loans are in default or arrears;

Note: A responsible entity should disclose, by number and value, what proportion of loans are in both default and arrears if these terms have different meanings in the scheme's lending policy.

(d) by number and value of loans, what is the nature of the security for loans made by the scheme (e.g. first or second ranking);

(e) what proportion of the total loan monies have been lent to the largest borrower and the 10 largest borrowers;

Note: We acknowledge that, for reasons of privacy or commercial confidence, it may not be appropriate to actually *name* the largest borrowers. The total loan monies lent to the ten largest borrowers can be disclosed as an aggregated amount.

(f) by number and value, loans that have been approved but have funds that have yet to be advanced and the funding arrangements in place for any of these undrawn loan commitments;

(g) by number and value, the maturity profile of all loans in increments of not more than 12 months;

(h) by number and value of loans, loan-to-valuation ratios for loans, in percentage ranges;

(i) by number and value of loans, interest rates on loans, in percentage ranges;

(j) by number and value, loans where interest has been capitalised; and

(k) a clear description of the non-loan assets of the scheme including the value of such assets.

RG 000.52 Disclosure should also cover the responsible entity's policy on the above matters and on how the scheme will lend funds generally. For example:

(a) the maximum loan amount for any one borrower;

(b) the method of assessing borrowers' capacity to service loans;

(c) the responsible entity's policy on revaluing security properties when a loan is rolled over; and

(d) the responsible entity's approach to taking security in relation to lending by the scheme (e.g. what types of security it takes and in what circumstances and whether the security must be income producing).

RG 000.53 Where a mortgage scheme invests, or may invest, in unlisted mortgage schemes (whether registered or unregistered), the responsible entity should also disclose its policy on investing in unlisted mortgage schemes, including the extent to which the responsible entity requires those schemes to satisfy the benchmarks in this section.

Explanation

RG 000.54 The primary assets of a mortgage scheme are the loans it makes to others. The quality of these loans and its other investments is a key element in the financial position and performance of the scheme. The more diversified a loan portfolio is, the lower the risk that an adverse event affecting one borrower or one type of loan will simultaneously affect the majority of borrowers, and therefore put the overall portfolio at risk.

RG 000.55 It is important that responsible entities disclose in their PDSs their approach to loan portfolio diversification. Most responsible entities will have a firm policy on how and when the scheme will lend funds. This should be disclosed as clearly and prominently as possible to help investors monitor the financial position and performance of the scheme over time.

RG 000.56 Responsible entities should also disclose the nature of the security for loans made by the scheme (e.g. its ranking, the value of the assets supporting the security and the financial position of any guarantor).

Note: If any security rights (e.g. mortgages) held by the scheme have been assigned or transferred to third parties, this needs to be disclosed as well.

RG 000.57 Investors should know what proportion of loans are in default and the scheme's approach to such loans. The responsible entity is relying heavily on payment of interest and repayment of capital on the loans it has made to pay distributions and withdrawal proceeds to investors and to maintain the financial position of the scheme. Therefore, investors have a strong interest in the proportion of loans in arrears and what the responsible entity is doing to address this.

RG 000.58 Investors can also benefit from having useful additional information about the diversity and strength of the scheme's loan book. It will help investors to know details of ranges for:

(a) the maturity profiles of loans;

(b) loan-to-valuation ratios; and

(c) interest rates on loans.

Benchmark 4: Related party transactions

RG 000.59 Responsible entities who transact with related parties of the scheme, including lending or investing scheme funds with related parties should disclose their approach to related party transactions, including:

(a) how many loans, investments and transactions they have made to or with any related party and the value of those loans, investments and transactions;

(b) their policy on related party transactions, including the assessment and approval process for related party lending and arrangements to manage conflicts of interest; and

(c) how the processes and arrangements are monitored to ensure their policy is followed.

Note: The term 'related party' should be interpreted broadly, taking into consideration the definitions of 'related party' in s228 (as applied to the scheme by Part 5C.7) and accounting standard AASB 124 *Related Party Transactions* and includes the responsible entity.

Explanation

RG 000.60 Related party transactions (including loans to, and investments in, related parties) are less likely to be monitored as robustly as those involving unrelated parties. This can affect valuations, loan-to-valuation ratios, due diligence and credit assessment processes.

RG 000.61 It is important that responsible entities disclose in the PDS their approach to related party lending, investments and other transactions. As discussed under the previous benchmark, we expect that most responsible entities will have a firm policy on how and when they will lend and invest funds and this should be disclosed to investors.

Note: Responsible entities are financial services licensees and have duties to adequately manage conflicts of interest: s912A(1)(aa). If appropriate, responsible entities may also need to obtain investor approval to related party transactions under Part 5C.7.

Benchmark 5: Valuation policy

RG 000.62 The responsible entity of a scheme should take the following approach to valuations of properties over which it has taken security:

(a) properties (i.e. real estate) should be valued on an 'as is' and (for development property) also on an 'as if complete' basis;

Note: See 'Key terms' for definition of 'as is' and 'as if complete' valuations.

(b) responsible entities should have a clear policy on how often they obtain valuations, including how recent a valuation has to be when they make a new loan; and

(c) responsible entities should establish a panel of valuers and ensure that no one valuer conducts more than 1/3 of the responsible entity's valuation work for the scheme.

RG 000.63 Responsible entities should also include information about the valuation of a particular property for a mortgage scheme where a loan secured against the property accounts for 5% of more of the total value of scheme's loan book. However, the responsible entity of a contributory mortgage scheme only needs to provide an investor with information about the valuation of a property securing a loan if the investor has, or is being offered, an interest in the loan.

Note: We would also expect responsible entities to include the 'cost' of such a property for comparison purposes.

RG 000.64 We expect valuers who accept an appointment to provide valuations for a mortgage scheme to:

(a) where possible, be registered under one of the state/territory valuer registration regimes; and

(b) include a warranty in their valuation reports that the report complies with all relevant industry standards and codes.

Explanation

RG 000.65 Robust and objective valuations are needed to ensure that the scheme's financial position is correctly stated in the PDS and ongoing disclosures.

RG 000.66 It is therefore important for investor confidence that independent experts perform the valuations, and that the process is transparent.

RG 000.67 It is in the interests of responsible entities that the valuations they obtain and use are robust and accurate. Responsible entities are responsible for the accuracy of the financial statements and other documents that rely on these valuations. Therefore, we expect that responsible entities will only use professional valuers who are registered or licensed in the relevant state or territory, and who subscribe to a relevant industry code of conduct. We also expect that responsible entities will be careful to ensure that their instructions to valuers are comprehensive and contain reasonable assumptions.

Note: We realise that not all states and territories have a registration or licensing regime for valuers at this time.

Benchmark 6: Lending principles—loan-to-valuation ratios

RG 000.68 Responsible entities should maintain the following loan-to-valuation ratios for loans made by the scheme:

(a) where the loan relates to property development—70% on the basis of the latest 'as if complete' valuation; and

(b) in all other cases—80% on the basis of the latest market valuation.

Note: The loan-to-valuation ratio should be based on the unencumbered value of the property.

RG 000.69 Where the loan relates to property development, the responsible entity should ensure that the scheme only provides funds to the developer in stages, based on external evidence of the progress of the development.

Explanation

RG 000.70 A scheme's approach to loan-to-valuation ratios is one indicator of how conservative or aggressive its lending practices are. Some schemes are willing to lend funds equal to a higher proportion of a property's value (sometimes up to or exceeding 100% of its value). Such ratios mean that the scheme is more vulnerable to the risk that a change in market conditions (e.g. a downturn in the property market) means it is unable to fully recover the money it has lent to borrowers. It also increases the risk that the security it has obtained from borrowers will not be sufficient to cover the loan.

RG 000.71 We have separated loans relating to property development from other property-related loans (e.g. residential mortgages). By property development, we mean loans whose main or primary purpose is for real estate developments (e.g. home units, retail, commercial, sub-divisions and industrial development). The benchmark loan-to-valuation ratio for property development loans is lower than for other loans because it is calculated on an 'as if complete' basis.

RG 000.72 Where funds are lent for property development activities, a loan-to-valuation ratio may be agreed upfront, but it is generally not appropriate to advance all of the funds to the developer upfront. Rather, we expect responsible entities to put systems and controls in place to ensure funds are only provided to the developer where there is satisfactory progress of the development (based on reliable external evidence of that progress). We also expect that the policy on how and when funds are provided to developers will be stated in the PDS.

Benchmark 7: Distribution practices

RG 000.73 Where the responsible entity expects a scheme to make distributions to members, the responsible entity should disclose:

(a) the expected source for such distributions (e.g. from income earned in the relevant distribution period, financing facility, application monies);

(b) whether this differs from the source of previous distributions;

(c) if it is expected that distributions may not be solely sourced from income received in the relevant distribution period, the reasons for making those distributions; and

(d) whether distributions sourced other than from income are sustainable.

Note: Any forward-looking statements should comply with s769C and Regulatory Guide 170 *Prospective financial information* (RG 170).

RG 000.74 If the scheme promotes a particular return on investments, the responsible entity should clearly disclose details of the circumstances in which a lower return may be payable, together with details of how that lower return will be determined.

Explanation

RG 000.75 It is important for investors to know how distributions are funded because this is an important indicator of the performance of the scheme. In some situations, distributions that are not solely funded out of scheme income for the relevant distribution period may be an indication that the distribution practices are not sustainable over the long term or may be insufficient to meet advertised returns. Accordingly, it is important that responsible entities disclose where distributions are sourced from and, where these are not sourced from scheme income, explain why.

RG 000.76 We understand that where scheme income is insufficient to meet advertised returns, schemes may fund distributions in a number of different ways (e.g. by reducing their fees, from scheme borrowings or from scheme capital) rather than paying a reduced return. Such practices have developed because competition in the mortgage scheme sector means that many schemes may prefer to meet advertised returns even if that means funding out of capital.

RG 000.77 Some mortgage schemes seek to give investors an assurance as to income stability by disclosing that a fixed return is generally payable. We consider that such disclosures will be misleading unless the responsible entity also makes prominent disclosure of:

(a) the mechanism by which it will seek to achieve a fixed return, together with any limitations of relying on that mechanism; and

(b) the circumstances in which investors may be paid a lower return and how that lower return will be determined.

Benchmark 8: Withdrawal arrangements

RG 000.78 The responsible entity should provide details of whether investors will have the ability to withdraw from a scheme. If investors are given the right to withdraw from a scheme, the responsible entity should clearly disclose:

(a) the maximum withdrawal period allowed under the constitution for the scheme. This disclosure should be at least as prominent as any shorter withdrawal period promoted to investors;

(b) any significant risk factors or limitations that may impact on the ability of investors to withdraw from the scheme (including risk factors that may impact on the ability of the responsible entity to meet a promoted withdrawal period); and

(c) the approach to rollovers, including whether the ‘default’ is that investment in the scheme are automatically rolled-over.

RG 000.79 If the scheme promotes a fixed redemption unit price for investments (e.g. $1 per unit), the responsible entity should clearly disclose details of the circumstances in which a lower amount may be payable, together with details of how that amount will be determined.

Explanation

RG 000.80 It is important for responsible entities to make investors aware of withdrawal arrangements so that investors form realistic expectations about their ability to withdraw from the scheme. Where a scheme constitution provides for a long withdrawal period but the scheme is promoted on the basis that withdrawal requests are satisfied within a much shorter period, it is important for responsible entities to clearly disclose that:

(a) the responsible entity does not have an obligation to satisfy withdrawal requests within the shorter period;

(b) the constitution provides a longer withdrawal period for satisfying withdrawal requests (including details of the longer withdrawal period); and

(c) if the scheme does not satisfy the statutory liquidity requirements, members will only have a limited ability to withdraw (if any).

Note 1: Members will only have a limited ability to withdraw if a scheme is not ‘liquid’ for the purposes of Part 5C.6.

Note 2: Where a responsible entity makes representations about likely future withdrawal periods, it must have reasonable grounds for those representations: s769C.

RG 000.81 Some mortgage schemes rely on investors keeping their funds invested beyond the end of the initial investment period. In some cases, the terms of issue allow this to occur automatically unless the investor makes a positive decision to withdraw their funds. In other cases, it is the investor who makes a positive decision to have their funds re-invested. It is important that investors fully understand the responsible entity's approach to rollovers through clear disclosure in the PDS, including details of:

(a) the default position on maturity;

(b) what investors need to do in order for their funds to be withdrawn or re-invested (including details of the relevant timeframes); and

(c) any restrictions on the ability of members to withdraw at the end of the initial period.

RG 000.82 ASIC considers that it is potentially misleading not to provide investors with updated information about their investment when they are considering whether to rollover their investment. Depending on the circumstances, the responsible entity may also need to provide investors with an updated PDS.

RG 000.83 Some mortgage schemes seek to give investors an assurance as to capital stability by disclosing that investments are generally redeemable at a fixed unit price. We consider that such disclosure will be misleading unless the responsible entity also makes prominent disclosure of:

(a) the mechanism by which it will seek to achieve a fixed withdrawal price (e.g. by relying on a third party guarantee), together with any limitations of relying on that mechanism;

(b) any restrictions on the ability of investors to withdraw from the scheme;

(c) what will occur if the portion of the net assets of the scheme attributable to an interest in the scheme has a value that is less than the fixed withdrawal price; and

(d) the circumstances in which investors may be paid a lower withdrawal price and how that lower price will be determined.

D Disclosure against the benchmarks—'If not, why not'

Key points

Responsible entities of mortgage schemes should use the benchmarks in Section C on an 'if not, why not' basis in meeting their disclosure obligations to investors: see RG 000.84–RG 000.86.

We expect responsible entities of both new and existing mortgage schemes to comply with these disclosure requirements from 31 October 2008. We also expect responsible entities for existing schemes to provide existing investors with updated disclosure against the benchmarks by 31 October 2008: see RG 000.87–RG 000.90.

The benchmarks also reflect information required for ongoing disclosure to investors. We encourage responsible entities to communicate this information to investors in the most effective way possible (e.g. by the scheme's website and regular reports): see RG 000.99–RG 000.115.

'If not, why not' approach

RG 000.84 Responsible entities should disclose whether they meet the benchmarks in Section C, and if not, why not. 'Why not' means explaining how a responsible entity deals with the business factor or issue underlying the benchmark (including the alternative systems and controls the responsible entity has in place to deal with the issue underlying the benchmark).

Note: Where a benchmark contains multiple requirements, if a responsible entity cannot meet all requirements under a benchmark, they should state that they do not meet the benchmark and clearly explain why they failed to meet particular requirements.

RG 000.85 Disclosure against the benchmarks is not intended to lead to longer and more complex PDSs. Rather, we expect that these disclosure proposals will help responsible entities produce PDSs that are more focused on the issues that matter to investors and are more clear, concise and effective.

RG 000.86 This approach is based on our view that the inherent risks for investors in mortgage schemes mean that information about these risks is required in both upfront and ongoing disclosures.

How to apply the benchmarks

RG 000.87 Our approach to additional and improved disclosure applies to both existing and new offers of interests in mortgage schemes. Table 5 explains how we expect responsible entities for existing and new mortgage schemes to disclose against the benchmarks on an 'if not, why not' basis.

RG 000.88 We will review updated investor disclosures for mortgage schemes in the period from 31 October 2008 to 31 December 2008 to check that this benchmarking information is adequately disclosed to investors on an 'if not, why not' basis: see RG 000.18.

Table 5: Implementing the 'if not, why not' approach against the benchmarks

Existing schemes—addressing benchmarks by 31 October 2008	By 31 October 2008, responsible entities of existing schemes should address the benchmarks on an 'if not, why not' basis in updated disclosure that is brought directly to the attention of existing investors: see RG 000.89–RG 000.90.
PDSs from 31 October 2008	All new PDSs issued on or after 31 October 2008 should disclose against the benchmarks on an 'if not, why not' basis: see RG 000.91–RG 000.98. If there are material changes to the scheme's performance against the benchmarks while the PDS is current, the responsible entity will generally need to issue a new or supplementary PDS. The responsible entity should also communicate the information to existing investors who will not receive the PDS: RG 000.105–RG 000.106.
Ongoing disclosures from 31 October 2008	Where there are any material changes to the scheme's performance against the benchmarks, the responsible entity should deal with this in ongoing disclosures. We encourage responsible entities to communicate this information to investors as soon as practical by the most effective means possible (e.g. by updates on the scheme's website). From 31 October 2008, periodic statements under s1017D should update the scheme's performance against the benchmarks (if this has not previously been notified to investors). Responsible entities should also consider whether it would help investors to give them more frequent updates of the scheme's performance against the benchmarks. We recommend that responsible entities update investors at least every 6 months. (See RG 000.99–RG 000.115.)

Updating existing investors

RG 000.89 The first information that responsible entities will provide to existing investors in response to the benchmarks and the scheme's performance against them will be after they have invested. By 31 October 2008, we expect responsible entities to provide existing investors with updated disclosure addressing each of the benchmarks in Section C on an 'if not, why not' basis.

RG 000.90 For example, this could be in a periodic statement under s1017D, on the website (if used to regularly update investors), or through another regular report to investors (e.g. a quarterly report). Another alternative would be to issue a supplementary PDS and send a copy to existing investors, or publish it on the website and notify investors that it is available and how to access it.

Upfront disclosure

RG 000.91 From 31 October 2008, a new PDS for an offer of interests in a mortgage scheme to retail clients should address the benchmarks in Section C on an 'if not, why not' basis. This means that it should state that the mortgage scheme either:

(a) meets the benchmark (including how it meets the benchmark, where appropriate); or

(b) does not meet the benchmark *and* explain how and why the responsible entity deals with the business factor or issue underlying the benchmark in another way.

RG 000.92 A PDS for interests in a mortgage scheme should contain a clear and prominent disclosure of the key features of the investment and its risks. This key features and risks disclosure should be in the first few pages of the PDS.

RG 000.93 We expect the PDS for a mortgage scheme to explain in a clear, concise and effective way:

(a) the business model of the mortgage scheme and what it will actually do with the money;

(b) the track record and experience of senior management; and

(c) what the nature of the interest in the mortgage scheme is (e.g. what withdrawal rights apply, if any).

The role of upfront disclosure

RG 000.94 The Corporations Act requires disclosure in the form of a PDS for an offer of interests in a mortgage scheme. The PDS must:

(a) make specific disclosures, including significant risks associated with holding the product (s1013D); and

(b) include all other information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to invest in the scheme (s1013E).

RG 000.95 Our benchmarks relate to matters that in any event must be disclosed under s1013D–1013E. Issues relating to liquidity, scheme borrowing, portfolio diversification, related party transactions, valuation policies, lending principles, distribution practices and withdrawal arrangements are all matters that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to invest in the scheme.

RG 000.96 We expect a responsible entity to comply with these benchmarks or explain why they do not. In addition, we consider that s1013D–1013E require:

(a) disclosure of these benchmarks and how they have been complied with;

(b) a statement that the responsible entity will comply with these benchmarks going forward and if not, why not; and

(c) in circumstances where there is non-compliance with these benchmarks, disclosure of the extent of non-compliance and the reason for non-compliance. In some circumstances non-compliance with these benchmarks is a risk that should be disclosed prominently.

Note: A PDS should address the benchmarks in Section C prominently and in one place (e.g. in the first few pages of the PDS either by a separate section or a clear and well-referenced table).

RG 000.97 We will consider exercising our stop order powers under s1020E if we think there is material non-disclosure or misleading disclosure of these matters. We believe that disclosure of compliance with these benchmarks upfront in a PDS promotes compliance with the requirement that PDSs should be worded in clear, concise and effective manner by encouraging comparability and uniformity of financial measures and highlighting issues which ASIC and industry experts consider crucial to making an investment decision.

RG 000.98 Experience suggests that clear, concise and effective PDS disclosure requires simple and clear disclosure of the business model of the mortgage scheme and the key risks associated with investing in it. We encourage responsible entities to use consumer-friendly tools as much as possible in disclosing key features and risks, including by using tables, diagrams and other comparative features.

Ongoing disclosures

Effective ongoing disclosure

RG 000.99 Where there have been any material changes to a responsible entity's performance against the benchmarks, including against the responsible entity's alternative approach to meeting the benchmarks, the responsible entity should explain these in ongoing disclosures.

RG 000.100 A responsible entity makes a number of statements in the PDS about how the funds being raised by the PDS will be used, and how the responsible entity will operate the mortgage scheme. These 'promises' are part of the basis on which the investor invests their money, and the investor should be given the opportunity to monitor the responsible entity's performance against these promises.

RG 000.101 Good ongoing disclosure therefore plays an important role in helping investors monitor their investment, evaluate its performance and decide if and when to exit their investment (provided exit mechanisms exist) or increase their investment.

RG 000.102 Responsible entities have a number of obligations to make ongoing disclosures to investors under the Corporations Act: see RG 000.104–RG 000.115. Apart from these legal requirements, we encourage responsible entities to use the most efficient and effective methods to communicate ongoing disclosure to investors. We consider that best practice is for responsible entities to give information directly to members or make it easily accessible (e.g. by updates on the scheme's website), even where the information is also lodged with ASIC.

RG 000.103 Investors should be informed how the responsible entity intends to make ongoing disclosures available to investors. For example, a responsible entity may choose to make ongoing disclosure generally available to retail investors in monthly or quarterly fund updates.

Note: On occasion, more formal communication (such as a supplementary PDS or s1017B notice) may be required in addition to these other methods of communication: see RG 000.104–RG 000.115.

The legal framework for ongoing disclosure

RG 000.104 Responsible entities of mortgage schemes have obligations to provide ongoing disclosure to investors under the Corporations Act, including:

(a) issuing a supplementary PDS if there are certain material changes to information in a current PDS;

(b) periodic statements to members under s1017D; and

(c) disclosure of material changes and significant events (s675 or 1017B).

Supplementary PDSs

RG 000.105 The benchmarks relate to information required in a PDS under the Corporations Act. A PDS must be given to prospective investors in various circumstances: s1012A – 1012C. The information in a PDS must be up to date as at the time when it is given: s1012J. Where there are material changes to a responsible entity's performance against the benchmarks, a responsible entity with a current offer open may need to issue a new or supplementary PDS.

Note: [CO 03/237] provides an exemption for updated information that is not materially adverse and which is made available.

RG 000.106 We consider that it is best practice to also make the information in a new or supplementary PDS available to existing investors (e.g. in a regular investor update or on the website).

Continuous disclosure

RG 000.107 If the responsible entity becomes aware of information that is not generally available and that a reasonable person would expect, if it were available, to have a material effect on the price or value of the interests in the scheme, s675 requires the responsible entity to lodge a document with ASIC containing the information.

RG 000.108 The benchmarks reflect information that would reasonably be expected to have a material effect on the price or value of interests in the scheme. Therefore material changes to the responsible entity's performance against the benchmarks may trigger s675, unless the information is already generally available.

Notifications of material changes and significant events

RG 000.109 If a mortgage scheme is not subject to continuous disclosure obligations under Ch 6CA, the responsible entity is required to give investors notice under s1017B of any material change to a matter, or a significant event that affects a matter, that would have been required to be specified in a PDS.

RG 000.110 In our view, diversions from the benchmarks are material issues that should be covered in notifications to investors under s1017B. Where such changes or events are adverse to investors, notifications generally need to be provided as soon as practicable and in any event within 3 months.

Periodic statements

RG 000.111 Responsible entities of mortgage schemes must give members a periodic statement under s1017D at least annually.

RG 000.112 Periodic statements must include details of:

(a) the information that the responsible entity reasonably believes the investor needs to understand their investment in the mortgage scheme; and

(b) details of any change in circumstances affecting the investment that has not been notified since the previous periodic statement.

RG 000.113 Periodic statements are designed to give investors regular updates about their investment. The benchmarks in Section C deal with the key features and risks for mortgage schemes. In our view, periodic statements should provide an update of a scheme's performance against the benchmarks if this has not previously been notified to investors.

RG 000.114 Disclosure in a periodic statement is not a substitute for compliance with other ongoing disclosure obligations (such as continuous disclosure notices or notifications under s1017B). Where there is a requirement to provide a continuous disclosure notice or notifications under s1017B, responsible entities must comply with the timeframes applying to those obligations and not delay compliance until the time they provide a periodic statement.

RG 000.115 Responsible entities should consider whether it would assist investors to provide them with more regular updates of their performance against the benchmarks. We recommend that responsible entities provide such updates to investors at least every 6 months.

E Advertising standards for all mortgage schemes

Key points

Responsible entities of all mortgage schemes (whether listed or unlisted) can promote investor understanding and minimise the risk of mis-selling by ensuring that advertising for their products meets certain standards: see RG 000.116–RG 000.138.

Responsible entities who fail to comply with these standards risk making false or misleading statements or engaging in misleading or deceptive conduct: see RG 000.139–RG 000.140.

Under general law, a publisher or other media conduit may also have some responsibility for an advertisement's content: see RG 000.141–RG 000.146.

Standards for advertisements

Repayment of principal

RG 000.116 Retail investors may confuse products where a return, interest rates or fixed term investment periods are advertised with bank or other deposits. Many mortgage schemes advertise one or more of these features. Retail investors may fail to realise that a mortgage scheme investment is an equity investment in a managed investment scheme and there is a higher risk of losing some or all of their money than is the case with a bank deposit.

RG 000.117 For this reason, any advertisement for mortgage scheme investments that are offered to retail investors should contain prominent disclosure that investors risk losing some or all of their principal investment.

Payment of returns and quotation of investment ratings

RG 000.118 Advertisements for mortgage schemes that are offered to retail investors should *only* quote returns on the investment if this is accompanied by prominent disclosure that there is a risk that the investment may achieve lower than expected returns.

Note: This includes advertisements with generic references to the return (e.g. to a 'very high', 'highly competitive', 'regular' or 'consistent' return) as well as to a specific return.

RG 000.119 References to returns in advertising can be very influential to retail investors. These references can be misleading if at the same time the investor is not given information about the likelihood of being paid that return.

RG 000.120 If an investment rating is used in a mortgage scheme advertisement, it should be properly explained. This may include:

(a) information about the rating scale;

(b) the meaning of the rating and where an investor can obtain further information about the rating; and

(c) the experience of the research house giving the rating (if it is not a prominent research house).

RG 000.121 Responsible entities should ensure that the impression the investment rating creates about the mortgage scheme being advertised is not misleading.

RG 000.122 Responsible entities should ensure that investment ratings used in advertisements for mortgage schemes are only quoted from research houses that hold an Australian financial services licence.

References to withdrawal periods, withdrawal rights or investment periods

RG 000.123 Many mortgage schemes operate on the basis that withdrawal requests will be satisfied within a relatively short period even though the constitution of the scheme allows for a much longer maximum period to satisfy withdrawal requests. We consider that an advertisement which promotes a withdrawal period or withdrawal rights will be misleading unless there is prominent disclosure:

(a) of any longer period within which the responsible entity may satisfy withdrawal requests;

(b) that there are circumstances in which the responsible entity may suspend withdrawals (if this is the case); and

(c) that members will only have limited rights to withdraw if the scheme does not satisfy the statutory liquidity test in the Corporations Act.

RG 000.124 Some mortgage schemes advertise fixed term investments (e.g. 6 months, 12 months). If the investor can only withdraw at the end of the fixed term by making a withdrawal request, the reference to the fixed term investment is likely to be misleading unless it is accompanied by prominent disclosure of the risk that the investor will not be paid their withdrawal proceeds within a reasonable period after the end of the fixed term.

References to fees

RG 000.125 Some mortgage schemes advertise that a particular type of fee is not payable or is payable at a low rate. If this arrangement is dependent on conditions being satisfied (e.g. it is a requirement that the member not withdraw from the scheme for a specified period of time), we consider the advertisement will be misleading unless there is prominent disclosure of:

(a) if it is advertised that no fee is payable, the circumstances in which a fee is payable, together with the amount of the fee; and

(b) if it is advertised that a fee is payable at a particular rate, the circumstances in which a higher fee is payable, together with the amount of the higher fee.

Comparisons with deposits and 'risk free' suggestions

RG 000.126 Advertisements for mortgage schemes should state that the mortgage scheme is not a bank deposit. Advertisements should also not suggest that:

(a) the mortgage scheme is, or compares favourably to, a bank deposit or other deposit product; or

(b) there is no or little risk of the investor losing their principal or not being paid a return.

RG 000.127 This means that the following terms should be avoided in advertisements for mortgage schemes: 'secure', 'secured', 'guaranteed', 'warranted', 'safe', 'deposit', 'first ranking' and 'fixed income'.

RG 000.128 We consider that the use of these terms (or similar terms) creates a misleading impression about the mortgage scheme and the risks involved with investing in it. They contribute to the misconception that investors can achieve higher returns than a bank deposit without the risk of losing their principal investment.

RG 000.129 Terms such as 'secure', 'secured', 'guaranteed' and 'warranted' convey an impression of a safe investment and, in our experience, they have a disproportionate effect on retail investors. We consider that investors will be left with a misleading impression about the risk profile of the mortgage scheme without a detailed explanation of:

(a) the nature of the security, guarantee or warranty;

(b) the fact that investors in the scheme are unsecured equity investors; and

(c) whether lenders to the scheme have priority over the assets of the scheme.

RG 000.130 We consider the use of terms such as 'fixed income' may also create a misleading impression that the returns an investor receives are not subject to change and that the returns are in the form of interest rather than a return from the revenue generated by the scheme.

Warning statements generally

RG 000.131 The warning statements required by RG 000.117–RG 000.126 should be prominent. For example, this will generally be the case if investors who notice the return statement (if any) will also be reasonably likely to notice the warning statements and be able to easily understand them. This will help ensure investors have a balanced impression of the mortgage scheme offering.

RG 000.132 We are not prescribing 'boilerplate' or standardised warning statements. It is the responsibility of the responsible entity to ensure that their advertisement is not misleading or deceptive and that the warning statements required by RG 000.117–RG 000.126 are effective.

Suitability statements

RG 000.133 Advertisements for mortgage schemes should not state or imply that the investment is suitable for a particular class of investor (e.g. 'this product is suitable for a conservative investor' or 'this product is suitable for a self-managed super fund'). Such a statement may be misleading as it may convey the impression that the responsible entity has actually assessed the suitability of the mortgage scheme for particular investors targeted by the advertisement.

Consistency with PDS disclosure

RG 000.134 Statements in mortgage scheme advertisements should be consistent with all corresponding disclosures on that subject matter in the PDS. In particular, responsible entities should take into account the disclosures in the PDS about the benchmarks set out in Section C.

RG 000.135 In ensuring consistency with disclosure in the PDS, responsible entities should be aware that an advertisement may be misleading if it quotes a statement from the PDS out of context.. For example, it may not be misleading to describe a return on a mortgage scheme product as 'guaranteed' in the PDS where sufficient information is given about the guarantee and its likely efficacy, whereas using the term 'guaranteed' in an advertisement is likely to be misleading.

Telephone inquiries

RG 000.136 Statements made over the telephone or in any correspondence in response to inquiries about mortgage schemes are subject to the same regulation for misleading and deceptive conduct as the advertisements. Therefore, the same restrictions apply (e.g. about using words such as 'secure', 'secured' and 'guaranteed').

RG 000.137 Responsible entities of mortgage schemes should ensure that all statements made by call centre staff (or other staff or contractors engaged by them) to prospective investors who respond to advertisements for mortgage schemes are consistent with disclosures on that subject in the PDS. In the case of returns, withdrawal periods, withdrawal rights, investment periods and fees, no statements should be made that would have been prohibited in the advertisement to which the enquiry related.

RG 000.138 To ensure compliance with this standard, responsible entities could develop a script and list of questions and answers that call centre staff and any other staff fielding these inquiries should adhere to.

How ASIC deals with contraventions

RG 000.139 Responsible entities of mortgage schemes who fail to comply with the advertising standards risk making false or misleading statements or engaging in misleading or deceptive conduct in contravention of the Corporations Act or ASIC Act.

RG 000.140 The law provides ASIC with various options for dealing with misleading or deceptive advertisements for mortgage schemes or mortgage scheme advertising that constitutes misleading or deceptive conduct. These include:

(a) issuing a stop order on any misleading or deceptive statements in an advertisement for a mortgage scheme;

(b) seeking an injunction against a responsible entity for mortgage scheme advertising that constitutes misleading or deceptive conduct;

(c) investigating potential criminal action for contraventions of s1041E of the Corporations Act or s12DF of the ASIC Act; and

(d) taking other regulatory action against a responsible entity where mortgage scheme advertising contravenes its obligations as a financial services licensee.

Note: See Regulatory Guide 156 *Debenture advertising* (RG 156) at RG 156.31–RG 156.32 for further guidance about when advertising may be misleading or deceptive.

The role of publishers and the media

RG 000.141 While the primary responsibility for advertising material rests with the organisation placing the advertisement, under general law the publisher may also have some responsibility for its content. This depends on whether the publisher received the 'advertisement for publication in the ordinary course of that business and did not know, and had no reason to believe, that its publication would amount to an offence against that provision': s1044A, Corporations Act; s12GI(4), ASIC Act.

RG 000.142 We believe that the advertising standards in this section of this guide give publishers knowledge of the type of conduct that would contravene the law.

This means that publishers should ensure that they are in a position to decline advertisements that:

(a) do not contain the statements required by RG 000.117 and RG 000.126;

(b) have any references to returns that do not comply with the standards in RG 000.118–RG 000.119;

(c) have any reference to withdrawal periods, withdrawal rights or investment periods that do not comply with the standards in RG 000.123–RG 000.124;

(d) use the words ‘secure’, ‘security’, ‘guaranteed’ or ‘warranted’ (or similar terms): see RG 000.127–RG 000.130; or

(e) contain suitability statements: see RG 000.133.

RG 000.143 We will assist publishers to identify potentially problematic advertisements by making available details of responsible entities of mortgage schemes that have previously had a stop order made against either their PDS or any of their advertisements. We expect publishers to scrutinise advertisements by these responsible entities with particular care.

RG 000.144 We also expect publishers to cease publishing an advertisement if we inform them that it is currently subject to a stop order. We will assist publishers by making this information available.

RG 000.145 Where a publisher contributes to the content of the advertisement (e.g. in writing advertorials) or otherwise has an active involvement in the promotion of the financial product (e.g. through co-branding or where a media personality uses their influence to promote a product), we regard the publisher to be in the same position as the responsible entity in terms of its responsibility to comply with the advertising standards in this section. We consider that this level of active involvement may mean that the general defence that publishers might claim against liability for content of an advertisement under s1044A is unlikely to apply.

RG 000.146 Generally, responsible entities will use the terms ‘mortgage, ‘mortgage scheme’, ‘mortgage trust’ or ‘mortgage fund’ to describe products subject to this regulatory guide. But we encourage publishers to specifically ask their advertising clients if the product they are advertising is regulated by this guide.

F Compliance plans

Key points

Compliance plans must set out measures for the responsible entity to comply with the Corporations Act and scheme constitution.

We expect compliance plans for mortgage schemes to set out adequate measures to ensure compliance with the disclosure and advertising obligations referred to in this guide.

We expect compliance committees and compliance plan auditors to be aware of these disclosure and advertising obligations and to have regard to them in carrying out their duties.

Responsible entities, compliance committees and compliance plan auditors should consider these disclosure and advertising obligations when assessing whether a compliance plan is adequate.

The compliance plan

RG 000.147 Compliance plans play a key role in protecting investors and promoting their interests. The law requires managed investment schemes to have a compliance plan: s601EA. The compliance plan must set out adequate measures for the responsible entity to ensure compliance with the Corporations Act and the scheme's constitution: s601HA. The responsible entity has a duty to comply with the compliance plan: s601FC(1)(h).

RG 000.148 Compliance plans should contain adequate procedures to ensure that responsible entities comply with their upfront and ongoing disclosure obligations, including their obligations in relation to disclosure against the benchmarks in this guide. Compliance plans should also contain adequate procedures to ensure that responsible entities comply with their advertising obligations.

RG 000.149 We do not expect that responsible entities will necessarily need to change their compliance plans to deal expressly with the disclosure and advertising obligations referred to in this guide. Good compliance plans should already contain procedures to ensure that responsible entities comply with all of their disclosure and advertising obligations under the law.

RG 000.150 However, we do expect responsible entities to critically examine existing compliance plans and consider whether they are adequate to ensure compliance with the obligations discussed in this guide. Regardless of whether a scheme has a compliance committee, responsible entities have a duty to ensure that compliance plans establish adequate measures to ensure compliance (including with disclosure and advertising obligations): s601FC(1)(g).

Compliance committees

RG 000.151 Many mortgage schemes have a compliance committee. A scheme is required to have a compliance committee unless at least half of the responsible entity's directors are external directors: s601JA. If the scheme does not have a compliance committee, the responsible entity's directors should be particularly vigilant about ensuring the responsible entity complies with the compliance plan and the compliance plan is adequate.

RG 000.152 The functions of a compliance committee are to:

(a) monitor the extent to which a responsible entity complies with the compliance plan and report its findings to the responsible entity;

(b) report any breach of the law or the scheme's constitution to the responsible entity;

(c) report to ASIC if the compliance committee considers that the responsible entity is not taking adequate action to deal with a matter reported under paragraph (b); and

(d) assess at regular intervals whether the compliance plan is adequate, to report to the responsible entity on the assessment and to make recommendations to the responsible entity about any changes that it considers should be made to the plan: s601JC(1).

RG 000.153 We expect compliance committees for mortgage schemes to be aware of the disclosure and advertising requirements identified in this guide. Compliance committees need to regularly assess whether the compliance plan contains adequate measures to ensure compliance by responsible entities with their:

(a) upfront and ongoing disclosure obligations, including disclosure in relation to the benchmarks; and

(b) advertising obligations, including the obligations discussed in Section E.

RG 000.154 If a compliance committee forms the view that a compliance plan is not adequate, it needs to report this to the responsible entity, together with recommendations about changes that should be made to the plan.

RG 000.155 A compliance committee should also monitor compliance by the responsible entity with the compliance plan. Where a compliance committee identifies non-compliance or a possible breach of the law (including a breach relating to the responsible entity's disclosure and advertising obligations), the compliance committee will need to make a report to the responsible entity and, if necessary, report the matter to us.

Compliance plan auditors

RG 000.156 Compliance plans are subject to an annual audit. The auditor of a compliance plan must give the responsible entity a report that states the auditor's opinion on whether:

(a) the responsible entity has complied with the compliance plan; and

(b) the plan continues to meet the requirements of the Corporations Act.

RG 000.157 We expect compliance plan auditors to be aware of the disclosure and advertising obligations in this guide. In determining whether a plan continues to meet the requirements of the Corporations Act, compliance plan auditors should carefully consider whether the compliance plan is adequate to ensure compliance with these disclosure and advertising obligations. If a compliance plan auditor becomes aware of a breach by the responsible entity of these obligations, the auditor may be required to report the breach to us under s601HG(4).

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001* (Cth) including regulations made for the purposes of that Act
'as if complete' valuation	An estimate of the market value of a property, assuming certain specified improvements are made
'as is' valuation	An estimate of the market value of a property in its current state (i.e. without any further improvements)
Australian Accounting Standards	Standards made for the purposes of s296(1) of the Act.
contributory mortgage scheme	A mortgage scheme under which an investor invests in a single mortgage loan through: • a general authority, where the investor receives a summary after the application is approved followed by a cooling off period; or • a specific authority where the investor receives a supplementary PDS prior to investing
Corporations Act	*Corporations Act 2001* (Cth) including regulations made for the purposes of that Act
CP 99	An ASIC consultation paper (in this example, numbered 99)
market value	An estimate of the amount for which the property or asset could exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction
mortgage loan	A loan secured by a mortgage over real property (including residential, commercial, industrial or retail property or vacant land)
mortgage scheme	A managed investment scheme that has or that is likely to have at least 50% of its non-cash assets invested in mortgage loans and/or unlisted mortgage schemes Note: This definition includes contributory mortgage schemes.
PDS	Product Disclosure Statement
related party	The term 'related party' should be interpreted broadly, taking into consideration the definitions of 'related party' in s228 (as applied to the scheme by Part 5C.7) and accounting standard AASB 124 *Related Party Transactions* and includes the responsible entity.
RG 69	An ASIC regulatory guide (in this example, numbered 69)

Term	Meaning in this document
rollovers	Where an existing investor keeps their money in the existing mortgage scheme for an additional term (whether on the same or slightly different terms)
s1017B (for example)	A section of the Corporations Act (in this example, numbered 1017B)

Related information

Headnotes

Mortgage schemes, pooled mortgage schemes, contributory mortgage schemes, listed, unlisted, benchmarks, advertising, misleading, deceptive, responsible entities, valuers, compliance plans, compliance committees, compliance plan auditors

Regulatory guides

RG 69 *Debentures—improving disclosure for retail investors*

RG 118 *Commentary on compliance plans: Contributory mortgage schemes*

RG 119 *Commentary on compliance plans: Pooled mortgage schemes*

RG 132 *Managed investments: Compliance plans*

RG 144 *Mortgage investment schemes*

RG 156 *Debenture advertising*

RG 170 *Prospective financial information*

Legislation

Ch 2M, 6CA, Pt 7.9, 7.10 Corporations Act, ASIC Act

Consultation papers and reports

CP 99 *Mortgage schemes—improving disclosure for retail clients*