REPORT 138

Report on submissions for CP 99 Mortgage schemes—improving disclosure for retail investors

September 2008

About this report

This report highlights the key issues that arose out of the submissions received to Consultation Paper 99 *Mortgage schemes—improving disclosure for retail investors* (CP 99) and details our responses to those issues.

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.

Disclaimer

This report 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.

This report does not contain ASIC policy. Please see Regulatory Guide 45 *Mortgage schemes—improving disclosure for retail investors* (RG 45).

Contents

A Overview/Consultation process

Key points

In July 2008, we consulted on improving disclosure for retail investors in mortgage schemes.

Although we have continued to apply the benchmark approach to disclosure, we have made some changes to the final regulatory guide in response to submissions.

About our consultation

1 On 8 July 2008, we released Consultation Paper 99 *Mortgage schemes—improving disclosure for retail investors* (CP 99): see www.asic.gov.au/cp. CP 99 set out our proposals to improve disclosure to retail investors in the mortgage scheme market and included a draft regulatory guide, which provided greater detail on these proposals.

Note: The final guide, Regulatory Guide 45 *Mortgage schemes—improving disclosure for retail investors* (RG 45), was published on 2 September 2008. A copy of the final guide is available at www.asic.gov.au/rg.

2 The proposed improved disclosure measures in CP 99 were based on the 'if not, why not' reporting we introduced for unlisted, unrated debentures: see Regulatory Guide 69 *Debentures—improving disclosure for retail investors* (RG 69). Under this approach, issuers report to investors against certain benchmarks. They must either meet the benchmark, or explain why not and how they deal with the issue underlying the benchmark in another way.

3 As part of our consultation, we wrote to 107 responsible entities of unlisted mortgage schemes seeking their feedback on CP 99. This report highlights the key issues that arose out of the submissions received to CP 99 and our response to those issues.

4 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question for feedback in CP 99. We have limited this report to the key issues.

5 For a list of non-confidential respondents to CP 99, see the Appendix. Copies of these submissions are on the ASIC website at www.asic.gov.au/cp under CP 99.

Responses to consultation

6 We received 30 written responses to CP 99 from a wide variety of sources including responsible entities of mortgage schemes (both large and small), relevant industry bodies, compliance plan auditors, law firms, and ratings providers. We also met with a number of interested parties during the consultation period, including responsible entities and industry bodies.

7 We are grateful to respondents for taking the time to provide us with their comments. Table 1 summarises our consultation in this area.

Table 1: Mortgage scheme coverage from consultation

Number of responsible entities visited	14
Percentage of total responsible entity population	13%
Number of mortgage schemes those responsible entities represent	59
Percentage of total number of schemes	31%
Assets managed by responsible entities visited	$29 billion
Percentage of total assets under management of all responsible entities of mortgage schemes	74%
Written submissions from various sources	30

8 There was widespread support for ASIC to improve retail investor protection in the area of mortgage schemes. We have therefore decided to proceed with implementing improved disclosure against a series of benchmarks in this area based on the ‘if not, why not’ principle.

9 In this report, we have grouped comments from the submissions and our response to them based on the main issues raised by respondents:

(a) who the benchmarks should apply to (see Section B);

(b) the proposed benchmarks for unlisted mortgages schemes and how they should apply to disclosures, including the proposed timing for implementation (see Sections C and D);

(c) proposed advertising standards for mortgage schemes (whether listed or unlisted) (see Section E);

(d) how the benchmarks could be supported by compliance plans, compliance committees and compliance plan auditors (see Section F); and

(e) the use of investment ratings in advertisements for mortgage schemes (see Section G).

B Who should the benchmarks apply to?

Key points

While most submissions supported our proposed definition of a 'mortgage scheme', some submissions suggested that the definition should be modified.

Some submissions suggested that certain benchmarks should not apply to contributory mortgage schemes.

Definition of 'mortgage scheme'

10 Most submissions supported the proposal 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. However, some respondents indicated that there is not a universally-agreed definition of mortgage scheme.

11 Some respondents suggested that our proposed definition should be modified. Among the suggestions received were:

(a) the definition for mortgage schemes should be confined to schemes where 100% of non-cash assets are mortgages;

(b) the 50% non-cash assets limit is too low; and

(c) the definition should apply where a majority of total assets are intended to be invested in mortgages.

ASIC's response

We have decided to keep our proposed definition since we consider it gives the necessary flexibility to include schemes that do not invest solely in mortgages without being too broad.

We think it is appropriate to exclude cash assets when applying the test since many mortgage schemes hold a significant proportion of their assets in cash. We also think that restricting the definition to schemes that have 100% of their non-cash assets in mortgages would be too narrow.

Contributory mortgage schemes

12 Contributory mortgage schemes give investors an interest in a specific mortgage, rather than in a pool of mortgages. In CP 99, we proposed not to apply the following benchmarks to contributory mortgage schemes:

(a) the portfolio diversification benchmark; and

(b) certain aspects of the valuation benchmark.

13 We received submissions suggesting that some other benchmarks (including scheme borrowing, lending principles, distribution practices and withdrawal arrangements) should also not apply to contributory mortgage schemes, as they are inappropriate to the structure of these schemes. In particular, submissions stated that the liquidity benchmark should not apply, as contributory mortgage investors invest in a specific mortgage and are not entitled to be repaid until the loan principal is repaid.

> *ASIC's response*
>
> We have accepted submissions that the liquidity benchmark should not apply to contributory mortgage schemes, given that investors in these schemes will generally only be repaid when the underlying mortgage loan is repaid.
>
> We have provided additional guidance in the final guide on how we consider contributory mortgage schemes should meet benchmarks dealing with valuation policy, lending principles, distribution practices and withdrawal arrangements.

C Benchmarks for unlisted mortgage schemes

Key points

This section outlines the key issues from submissions and our response for each of the proposed benchmarks in CP 99:

- Liquidity (see paragraphs 14–18);
- Scheme borrowing (see paragraphs 19–24);
- Portfolio diversification (see paragraphs 25–27);
- Related party transactions (see paragraphs 28–30);
- Valuation policy (see paragraphs 31–34);
- Lending principles—loan-to-valuation ratios (see paragraphs 35–37);
- Distribution practices (see paragraphs 38–41); and
- Withdrawal arrangements (see paragraphs 42–43).

Benchmark 1: Liquidity

14 Liquidity is a powerful indicator of the ability of the scheme to meet its short-term commitments. Our experience and advice suggests that adequate liquidity is a key feature in the ability of responsible entities to meet investors' expectations about withdrawing from those schemes.

15 To improve disclosure of scheme liquidity, we proposed in CP 99 that responsible entities should:

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

(b) ensure that at all times the scheme has cash or cash equivalents to meet projected cash needs over the next 3 months;

(c) not include undrawn amounts under credit facilities but may include a reasonable estimate of new investment inflows when determining scheme liquidity; and

(d) disclose their policy on balancing the maturity of their assets and the maturity of their liabilities.

16 We also consulted on whether responsible entities should hold a minimum of assets as liquid assets (e.g. 10%). Most respondents felt that responsible entities should not have to hold a minimum amount of assets as liquid assets for the following reasons:

(a) It is the responsibility of the responsible entity to determine what is best for the scheme and investors.

(b) It impacts on product construction/innovation and this would be constrained by setting minimum levels.

(c) The level of actual assets that is appropriate for the operation of the scheme will differ, and the liquid assets held will have an impact on the risk and return of the scheme.

(d) It would be difficult for a responsible entity to maintain a set percentage of the mortgage scheme assets as liquid assets because the cash and other liquid assets of the scheme change daily with withdrawals and new application monies.

17 Most submissions were opposed to excluding undrawn amounts under credit facilities in the calculation of scheme liquidity as they considered that to exclude such facilities would be uncommercial. It was submitted that such facilities are often maintained for the purpose of ensuring that a scheme is able to match its current assets and current liabilities. One submission agreed with the proposal, as undrawn amounts under credit facilities are better classified as debt.

18 Respondents also generally agreed that a reasonable estimate of new investment inflows should be included to determine scheme liquidity.

ASIC's response

Given that investors in contributory mortgage schemes will generally only be repaid when the underlying mortgage loan is repaid, we have decided that the liquidity benchmark will not apply to contributory mortgage schemes.

In line with submissions, responsible entities need not hold a minimum amount of assets as liquid assets. We consider that this requirement would currently be too restrictive.

Given recent debt market turbulence and the difficulties that can be faced in relying on credit facilities when a scheme is in financial difficulties, we have decided to continue to exclude undrawn amounts under credit facilities for the purposes of the 3-months cash flow requirement.

We will monitor the effectiveness and appropriateness of the current liquidity benchmark and consider whether any future adjustments need to be made.

Benchmark 2: Scheme borrowing

19 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.

20 To improve disclosure of scheme borrowing, we proposed in CP 99 that 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.

21 Respondents were generally supportive of disclosure of this information and agreed that 12-month increments were appropriate. Some minor technical amendments were suggested, in particular the use of the term 'borrowings' rather than 'debt'. One respondent suggested that similar information on interest rate hedging should be disclosed, including if no hedging arrangements were in place.

22 We also consulted as to whether responsible entities should have to disclose probable or likely breaches of loan covenants in addition to actual breaches of loan covenants. Several submissions raised concerns with disclosing potential breaches of loan covenants, including that it would be difficult to define a potential breach and would involve a degree of prediction which could make it misleading and deceptive to retail investors. One submission noted that if a potential breach of a loan covenant is likely to have a material effect on the value of an investor's investment, it would require immediate disclosure in any case.

23 We proposed that where debt 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. A number of respondents were concerned that because many external factors can impact on a responsible entity's ability to refinance debt, it may not have a reasonable basis to disclose the prospects of refinancing.

24 We also consulted on whether we should set a maximum limit beyond which schemes should not borrow against the assets of the fund. Most submissions opposed the imposition of a prescribed maximum limit as the level of scheme borrowing is a business decision that depends on a number of factors and should be at the discretion of the responsible entity. Most submissions noted however that the extent of borrowing against the assets of the fund should be disclosed.

> *ASIC's response*
>
> Responsible entities should explain any risks associated with their borrowing and credit facility maturity profile, including whether borrowings have been hedged and if so, to what extent.
>
> If loans are due to mature within 12 months, it is important for investors to be informed about the prospects of refinancing. We have therefore kept this aspect of the benchmark. It would clearly be inappropriate for a responsible entity to make a forecast about the prospects of refinancing if there is no reasonable basis for this.

ASIC's response (cont.)

We have clarified that if the responsible entity has no reasonable grounds for commenting on the prospect of refinancing or possible alternative actions, then they should state this and explain why to investors. We expect such forward-looking statements to comply with s769C and Regulatory Guide 170 *Prospective financial information* (RG 170).

We consider that, in some cases, investors would reasonably require information on likely breaches of loan covenants (e.g. if the responsible entity has approached the lender about a likely breach and has been informed that the loan is likely to be terminated if the breach occurs).

Benchmark 3: Portfolio diversification

25 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. It is important that responsible entities disclose in their PDS their approach to loan portfolio diversification.

26 To improve disclosure of the loan portfolio, CP 99 proposed that responsible entities should disclose the current nature of the mortgage scheme's investment portfolio, including:

(a) key information about the scheme's loan portfolio; and

(b) the scheme's policy on lending funds or investing in unlisted mortgage schemes.

27 Overall, there was a broad support for this proposal. One respondent raised a concern that meeting the benchmark might involve disclosure of private or commercially sensitive information and that the responsible entity should be excused from meeting the benchmark where this would be the case. Another submission stated that disclosure of a scheme's hedging strategies and use of derivatives should be disclosed.

ASIC's response

We believe that disclosure of the key factors proposed in the benchmark is important information for investors. We agree that the use of derivatives by the scheme is also relevant information that should be disclosed to investors and have included this in the final guide.

In our view, the benchmark would not generally involve the disclosure of private or commercially sensitive information as the information is to be disclosed by number and value of loans, rather than by identifying individual loans or borrowers. Although the proportion of the total loan monies lent to the largest borrower and the 10 largest borrowers should be disclosed, we have made it clear that for reasons of privacy or commercial confidence, it may not be appropriate to actually name the largest borrowers.

Since the benchmarks are applied on an 'if not, why not' basis, if information is private or commercially confidential, the responsible entity may choose not to disclose the information and identify the reason why it has not met the relevant aspect of the benchmark.

Benchmark 4: Related party transactions

28 Related party transactions are less likely to be monitored as robustly as those involving unrelated parties. This can affect loan-to-valuation ratios, due diligence and credit assessment processes.

29 In CP 99, we proposed that responsible entities who transact with related parties of the scheme should disclose their approach to these 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.

30 Submissions received did not highlight any significant issues associated with the related party transaction benchmark.

> *ASIC's response*
>
> Given the risks of related party transactions and respondents' agreement about the appropriateness of the benchmark for all mortgage schemes, we have not made material changes to this benchmark in the final guide.

Benchmark 5: Valuation policy

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

32 In CP 99, we proposed that the responsible entity of a scheme should take the following approach to valuations of properties over which it has taken security:

(a) all property should be valued on an 'as is' basis and for development property also on an 'as if complete' basis;

(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 the 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.

33 We also proposed that responsible entities should include information about the valuation of a particular property for a mortgage scheme where a loan secured against the property accounts for 5% or more of the total value of the scheme's loan book.

34 Although submissions were generally supportive of the need for a valuation benchmark, some submissions raised a concern that ensuring that no one valuer conducts more than 1/3 of the responsible entity's valuation work would be difficult in regional areas.

> *ASIC's response*
>
> We have not made any material changes to this benchmark.
>
> While ensuring that no one valuer conduct more than 1/3 of the valuation work may be difficult in regional areas, we consider that it is important to address the risk that the scheme's valuation work is not sufficiently diversified. In these circumstances, we would expect the responsible entity to disclose that insufficient valuers exist in the region to meet the benchmark.
>
> We have also clarified that the 1/3 proportion of valuations is to be determined by reference to the value of properties, rather than by the number of properties.

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

35 A scheme's approach to loan-to-valuation ratios is one indicator of how conservative or aggressive its lending practices are. In CP 99, we proposed that 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.

36 Some submissions opposed the imposition of mandated loan-to-valuation ratios, arguing that risks around loan-to-valuation ratios should be addressed through disclosure and not through setting prescribed limits.

37 Most submissions agreed with the proposed loan-to-valuation ratios. However, one respondent stated that for property development lending a ratio of 85% is standard and proposed that both ratios should be increased to this level.

> *ASIC's response*
>
> We consider that it is appropriate to have a benchmark that specifies levels of loan-to-valuation ratios. Higher loan-to-valuation ratios indicate a greater risk of default, which in adverse market conditions could result in a mortgage scheme being unable to fully recover monies it has lent to borrowers.
>
> We have decided to keep the proposed loan-to-valuation ratios. We note that these are consistent with the benchmark loan-to-valuation ratios that apply to debenture issuers that on-lend money for property-related activities: see RG 69.77.
>
> We will monitor the effectiveness and appropriateness of the current loan-to-valuation ratios and consider whether any future adjustments need to be made.

Benchmark 7: Distribution practices

38 It is important for investors to know how distributions are funded because this is an important indicator of the performance of the scheme. In CP 99, we proposed that where the responsible entity expects a scheme to make distributions to members, the responsible entity should disclose:

(a) the expected source for such distributions;

(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.

39 We received mixed responses on this proposed benchmark. Some submissions supported disclosing the sustainability of distributions sourced other than from income for investors to be aware of the risks associated with the payment of those distributions.

40 However, others opposed the benchmark noting that requiring the responsible entity to make statements as to their expectation of the source of payment of distributions and the sustainability of distributions might be misleading to investors.

41 Comments were also received that ASIC should provide guidance on the meaning of 'sustainable' if we proposed to keep this benchmark, including whether this concept refers to a particular period of time and/or to an indication of a particular level of distributions. One respondent suggested that the appropriate information that should be disclosed would be the assumptions under which distributions will remain sustainable and the risks which may affect whether they will be sustainable.

ASIC's response

Distributions that are funded from sources other than scheme income for the relevant distribution period may indicate that the distribution practices are unsustainable over the long term or may be insufficient to meet advertised returns. Accordingly, it is important that investors know where distributions come from and, if they come from sources other than scheme income, whether this is sustainable.

We have changed this benchmark so that it includes only information on current and forecast distributions. If the current distribution or forecast distribution is sourced other than from realised income, we have clarified that the relevant period over which responsible entities should disclose whether this is sustainable is the next 12 months. We believe this information is material to an investor's decision whether or not to invest in the scheme.

ASIC's response (cont.)

A responsible entity should not make statements about an expected source for distributions and the sustainability of distributions if it might be misleading to investors. If a responsible entity does not have reasonable grounds for stating whether distributions are sustainable, it should explain this.

Benchmark 8: Withdrawal arrangements

42 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. We proposed that 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; and

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

43 Submissions generally supported our approach to this benchmark. However, some submissions noted that so long as the responsible entity ensures that:

(a) the PDS remains up-to-date;

(b) continuous disclosure requirements are met; and

(c) current investors are notified of any reissue of a PDS or supplementary PDS,

then there would be no need to provide any rollover investors with extra disclosure at rollover as they would have all current information available to them through normal disclosure. Other submissions noted that investors should be notified of where they can get updated disclosure (e.g. on a website) before a rollover occurs.

ASIC's response

Overall, we have left this benchmark largely unchanged.

We consider that a responsible entity's policy on rollovers should be clearly disclosed in all PDSs. It is important for investors to know in what circumstances an investment may be rolled-over at the end of the initial term (e.g. whether it is possible for this to happen automatically unless the investor makes a positive decision to withdraw).

We also state in our final regulatory guide 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.

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

Key points

In response to submissions, the final guide gives additional guidance on applying the benchmarks to upfront and ongoing disclosures.

Some responsible entities were concerned that the proposed start date for disclosure against the benchmarks would be difficult to achieve. However, the benefits for investor protection were also noted.

Upfront disclosure in a PDS

44 In CP 99, we proposed that a PDS for an unlisted mortgage scheme should address each of the benchmarks 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.

45 Submissions that expressed a view were generally supportive of our approach to disclosure against the benchmarks. Most submissions supported our expectations of upfront disclosure in a PDS. However, some respondents queried where the benchmark disclosure should appear (e.g. should the benchmarks be addressed in a separate section of the PDS?).

46 Some submissions were concerned with the suitability of expecting this sort of disclosure in a PDS, stating that the PDS is an infrequent document and that disclosure would be better served by online updates through incorporation by reference. One respondent noted that having to issue a supplementary PDS if benchmark disclosure information in a PDS is out-of-date would require frequent publication of a supplementary PDS, which may not be appropriate. A number of respondents asked us to clarify when a supplementary PDS would be required.

47 A few respondents also suggested that the benchmark disclosure information was inconsistent with clear and concise disclosure.

ASIC's response

We have provided greater guidance on how information dealing with the benchmarks should be set out in a PDS. We consider that key information will be prominently disclosed if it is set out in the first few pages of the PDS. However, if the information is better included later in the document, the first few pages of the PDS should provide a summary of the information with a clear reference to more detailed disclosure.

We have also explained that for existing PDSs that continue in use after 30 November 2008, responsible entities should either:

- include the benchmark disclosure information on a website referred to in the PDS (if the omission of benchmark disclosure information from the PDS is not materially adverse); or
- update the PDS by a new or a supplementary PDS so that it includes the benchmark disclosure information.

Note: PDSs commonly allow information to be updated through a website if the updated information is not materially adverse: see Class Order (CO 03/237) *Updated information in product disclosure statements*. We consider that if the omission of the benchmark disclosure information from an existing PDS is not materially adverse, the responsible entity will generally be able to rely on CO 03/237 to update the PDS for this information without the need for a supplementary or new PDS.

The final guide provides more guidance on how the benchmark disclosure information can be clearly, concisely and effectively presented.

Ongoing disclosure

48 In CP 99, we proposed that if there were any material changes to a responsible entity's performance against the benchmarks, including to any alternative approach to meeting the benchmarks, the responsible entity should explain this in ongoing disclosures. We proposed that best practice would be for the responsible entity to give this information directly to members or make it easily accessible.

49 We also:

(a) proposed that periodic statements under s1017D should update the scheme's performance against the benchmarks; and

(b) recommended that responsible entities update investors at least every 6 months about the scheme's performance against the benchmarks.

50 Most submissions saw no practical problems with informing investors on an ongoing basis about the performance of the mortgage scheme.

51 A couple of submissions were opposed to requiring ongoing disclosures to be contained in a periodic statement. They stated that periodic statements are intended to provide investors with information on their particular investment on a transactional basis and to add information on benchmarks would be

excessive and inappropriate. Some submissions sought clearer guidelines on how the proposals for ongoing disclosure would operate.

> *ASIC's response*
>
> Ongoing disclosure plays an important role in ensuring that investors in a mortgage scheme are kept properly informed about their investment. We have clarified our expectations for ongoing disclosure based on the recommended 6-monthly updates.
>
> In particular, we have provided that, although it is not necessary to repeat information that has not changed in these updates, we consider it is good practice to advise investors in writing:
>
> - of any material changes to the benchmark disclosure information since the last update (so far as the responsible entity is aware);
> - how to access the scheme's benchmark disclosure information on the website (if available there); and
> - that they are entitled to a hard copy of the benchmark disclosure information on request.
>
> If a responsible entity does not otherwise report to investors, they should update them on the status of the benchmark disclosure information in the periodic statement. The periodic statement is merely one option for updating investors (e.g. where the responsible entity does not provide quarterly or half-yearly reports).

When you need to disclose against the benchmarks

52 In CP 99, we proposed 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.

53 We also proposed 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.

54 Some responsible entities were concerned that the proposed start date would be difficult to achieve and asked for additional time. One submission stated that some data would need to be manually collated and system changes would have to be implemented to automate data collection. Other submissions noted that the proposed timing would be difficult especially for responsible entities with multiple schemes, given that the proposed timing coincides with financial statement and audit requirements for 30 September.

55 Other submissions thought that, although the timetable was tight, it was appropriate in light of the investor protections that would be provided. An industry representative group submitted that, while 31 October 2008 was appropriate for online updates, additional time should be allowed for updates to PDSs.

ASIC's response

Due to the number of submissions on the difficulties with applying the benchmarks by 31 October 2008, we have allowed an extra month in the final guide, meaning that responsible entities should disclose against the benchmarks by 30 November 2008.

We have also responded to the preference for online disclosure in the first instance by confirming that the initial update to existing investors can be done by way of an online disclosure, provided that the responsible entity currently communicates with investors in this way.

We have confirmed that responsible entities may also be able to update benchmark disclosure information in existing PDSs through online disclosure, provided that omitting the information in the PDS itself would not be materially adverse to investors: see CO 03/327.

E Advertising standards for all mortgage schemes

Key points

Submissions were mixed on the proposed content or commencement date of the advertising standards.

Some concerns included the possible difficulty in including additional information in advertisements, the potential for an increase in advertising costs, and the need for flexibility to tailor advertisements to the particular risks of a scheme.

56 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.

57 In CP 99, we proposed that:

(a) advertising by responsible entities should support investor understanding of any disclosure against the benchmarks and not convey messages inconsistent with them; and

(b) advertisements for all mortgage schemes (whether listed or unlisted) should meet the advertising standards from the date of publication of the final regulatory guide.

58 A couple of submissions were concerned with the proposed timing for the advertising standards. However, in general, submissions had no issues with the proposed commencement date.

59 One respondent submitted that the definition of ‘advertisement’ should differentiate between information that is produced with an intention to sell and information that is informative, with the later not being subject to the advertising standards. Another respondent had concerns that investors may increase their focus on returns given the risk disclosures are not differentiated to capture the real underlying risks of the scheme. This respondent supported a concept of categorisation between conservative, moderate and less conservative labelling of funds.

60 A couple of submissions stated it would be extremely difficult to include all of the proposed additional information in an advertisement. Others raised no practical difficulties associated with the proposed advertising standards. However, one submission noted that the advertising standards would increase advertising costs.

61 Finally, some submissions suggested alternate disclaimers to be included in an advertisement, stating that responsible entities should be given more flexibility to tailor the advertisement to the risks associated with the particular scheme.

ASIC's response

We have modified the scope of what is an 'advertisement' for the purpose of our standards. We have clarified that statements that are published on a website about a scheme will only be advertisements for the purposes of our guidance if they are intended to promote the scheme to retail investors.

We do not agree that it will be extremely difficult to include all the additional information in mortgage scheme advertisements. The level of information to be included is substantially similar to the level that is currently included in debenture scheme advertisements. We think the additional information is necessary to reduce the risk of investors being misled by advertisements for mortgage schemes.

Whilst there may be some arguments in favour of distinguishing between different types of mortgage funds (e.g. conservative, moderate), we think that in practice it would be too difficult to draw clear distinctions between different types of funds for the purposes of setting advertising standards.

F Compliance plans, compliance committees and compliance plan auditors

Key points

Most submissions saw no significant issues with the proposed role for compliance committees and compliance plan auditors in supporting the benchmarks when carrying out their duties.

62 In CP 99, ASIC proposed that compliance plans 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).

63 We also stated that we expected compliance committees and compliance plan auditors for mortgage schemes to be aware of the disclosure and advertising requirements and to have regard to these requirements in carrying out their duties.

64 Submissions received from auditors generally considered that compliance plans would not have to be modified to specifically address the benchmarks and advertising standards, but noted that responsible entities may have to implement new policies and procedures. Other submissions noted that, in most cases, no changes or only minor changes would be needed.

65 Most submissions saw no significant issues with the proposed role for compliance committees and compliance plan auditors in having regard to the benchmarks when carrying out their duties. Submissions varied on the costs that would be incurred by compliance committees and compliance plan auditors in fulfilling the proposed role. Some stated that it would be a substantial cost, while others stated that the cost would be minimal. Generally, submissions received from auditors stated that the proposals would have little impact on costs.

66 In CP 99, we also consulted on whether auditors of financial reports should 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 the liquidity benchmark, the responsible entity's cash flow projections and minimum cash holding.

67 Submissions from audit firms generally supported these proposals, subject to some qualifications about what a financial auditor could report on. Other respondents considered that the proposal was inappropriate.

> *ASIC's response*
>
> Consistent with submissions, we have made only minor changes to our proposals on compliance plans, compliance committees and compliance plan auditors. We expect that existing compliance plans would generally specify procedures that are adequate to ensure compliance with the disclosure and advertising obligations.
>
> We do not expect auditors of financial reports to audit the responsible entity's performance against the benchmarks or cash flow projections. We consider that the roles of compliance committees and compliance plan auditors mean that it is currently not necessary for auditors of financial reports to perform this audit role.

G Investment ratings

Key points

While submissions generally noted that investment ratings were useful to retail investors, several submissions noted the difficulties that retail investors face in interpreting investment ratings.

68 Some retail investors and their financial advisers use investment ratings as a source of information when deciding whether to invest in mortgage schemes. 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.

69 In CP 99, we proposed that references to investment ratings in mortgage scheme advertisements should be properly explained to retail investors so as not to create a misleading impression about the scheme.

70 Submissions said that investment ratings were useful to retail investors. However, several submissions noted the difficulties that retail investors face in interpreting investment ratings. Some submissions considered that retail investors placed too much weight on investment ratings.

71 Some respondents raised concerns about the proposal to provide additional information if the research house was not a prominent research house. Queries were also raised about which firms constitute a prominent research house.

ASIC's response

We have modified our original proposals so that advertisements that include an investment rating should state that investment ratings are only one factor to take into account when deciding whether to invest. We have kept our expectation that investment ratings in advertisements should be properly explained.

Given uncertainty about what research houses would be considered 'prominent', we have decided that advertisements need not provide additional information in this case. All research houses should hold an Australian financial services licence in any event. Based on submissions, the key risks for investors are that they do not understand investment ratings and that they place too much weight on them. Our standards for the use of investment ratings address these key risks.

We are considering how investment ratings are used by investors as part of a separate review (with Treasury) of the regulation of ratings agencies and research houses that was initiated by the Minister for Superannuation and Corporate Law in May 2008.

Appendix: List of non-confidential respondents

- Association of Mortgage Investment Corporations (NSW)
- Association of Mortgage Investment Corporations (Vic)
- Assured Management Limited
- Australasian Compliance Institute
- Australian Property Institute
- AXA Ltd
- Clarke and Barwood Lawyers
- Deloitte
- Elliot Tuthill Mortgages
- Equitable Australia Pty Ltd
- EquitiTrust
- Grant Thornton
- IFSA
- IMMS Financial Services
- KPMG
- Lismore Management Corporation Limited
- LM Investments Australia
- McCullough Robertson Lawyers
- McMahon Clarke Legal
- Owenlaw Mortgage Investment
- Private Mortgage Funding and Management
- Property Investment Research
- Rennick & Gaynor Mortgages
- RMBL Investments
- Standard & Poor's