



Investment & Financial Services Association Ltd

**Response to ASIC Consultation Paper 99
Mortgage Trust Schemes – improving disclosure for retail investors**

Dated: 5th August 2008

A. GENERAL COMMENTS

IFSA members are committed to best practice in the disclosure of the risks associated with mortgage trust investments.

To that end, IFSA has had a Guidance Note dedicated to promoting improved disclosure since 1999. In July 2008, this Guidance Note was reviewed and relaunched as IFSA Standard no. 18 'Best Practice Guidance for Disclosure in the Mortgage Trust Sector'.

The Standard aims to ensure that investors, whether investing directly or through a qualified Financial Planner, are able to understand the risks involved in Mortgage Trusts and are easily able to compare the investment policies of one fund against that of another as well as keep track of the composition of their fund on a regular basis.

Through the application of this Standard, scheme managers and Responsible Entities will take a consistent approach to communicating information about investment policies and the composition of the fund.

This Standard aims to reaffirm the role of the PDS and other communication mediums in relaying information to investors at the time of investment and on an ongoing basis.

As an IFSA Standard, compliance with the disclosure requirements listed is mandatory for IFSA members, however it is hoped that this Standard will raise the bar across the industry and ensure that disclosures made by scheme managers are meaningful to and comparable by investors.

In the development of IFSA's Standard two key factors were taken into account:

- The fact that PDSs have a long shelf-life limits the level of detail that can be provided within the PDS meaningfully. For this reason IFSA's Standard focuses on the PDSs role in the disclosure of the policies and principles of investments, as opposed to the exact composition of the fund at any single point in time. It is considered best practice for this level of detail to be provided to investors in ongoing disclosure documents and online. As per IFSA's Standard, online information should be updated at least quarterly and accompanied by the date at which the information was correct.
- While the industry is committed to improving disclosures, bringing all documents and practices in line IFSA's Standard will take time. It was therefore considered appropriate for the Standard to encourage members to comply with this Standard at the earliest opportunity, but that all PDSs produced after the 1st January 2010 and all online and regular member communications being produced after 1st July 2009 must comply.

These two factors have relevance in relation to the industry's response to ASIC's Consultation Paper No. 99.

Commencement date

The industry has expressed concerns with ASIC's 31st October 2008 commencement date.

The feedback received by IFSA suggests that the proposed timetable will be challenging for most members in that some data will need to be manually collated initially (eg details on valuer usage across the portfolio) then system changes implemented to automate data collection. These system enhancements are required to both review, monitor and report against benchmarks will be significant.

The additional drafting of fund profiles and additional disclosure, promotional and advertising material and the associated and ancillary amendments required may also be substantial.

EXAMPLE 1:

Y already has plans to roll the PDS for one of the affected products in November. Their plans require that the updated PDS be ready to go to print in mid-September. This leaves six weeks from now to meet and incorporate the final requirements of the draft Consultation Paper, review and sign off the updated material and have.

Directors ratify the updated material as part of the Due Diligence process. Given the final requirements are unlikely to be available until September) it is not feasible to incorporate the requirements in their November PDS roll.

The Role of the PDS

EXAMPLE 2:

X's mortgage trust offering sits within an integrated PDS, as only one out of 100 investment options under that product. To a large extent the other 99 investment options share the same general disclosures, which adequately address the current disclosure requirements in the law and adhere to the clear, concise and effective principles.

Recommendation

The industry considers it appropriate to encourage all companies to comply with the Regulatory Guide as early as possible. It would also be appropriate to for the 31st October 2008 to be the commencement date for online information. However we suggest that the commencement date for new and existing scheme PDSs be the 31st March 2009.

B. RESPONSE TO SPECIFIC QUESTIONS

What would the benchmarks apply to?

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

IFSA's Standard no.18 defines a Mortgage Trust as all schemes marketed to end investors where a majority of the assets are/or are intended to be Mortgage investments.

There was much discussion by the industry about the definition used within IFSA's Standard. It was felt that a principled approach (as opposed to an exact percentage) was preferable.

In discussion with ASIC, we believe that Draft Regulatory Guide is designed to impact on the same schemes as the IFSA Standard, however the definition as it currently stands will have some unintended consequences unless clarified.

ASIC proposes to apply benchmarks to mortgage schemes which are defined 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."

The definition, as it is presently drafted, suggests that the threshold test is whether 50% or more of a scheme's "non-cash assets" are invested in mortgage loans and/or unlisted mortgage schemes.

If this is correct then a scheme with 20% of its total assets held as non-cash assets would only require 10% of its total assets to be invested in mortgage loans and/or unlisted mortgage schemes for the benchmarks to be applicable.

Potentially schemes with minor holdings of the relevant "mortgage investments" would be subject to the benchmarks and indeed the definition might apply to other types of funds such as diversified funds with a small exposure to mortgage loans or schemes.

ASIC's definition as it currently stands will also require clarification regarding what constitutes an "investment" in a "mortgage loan" and/or "unlisted mortgage scheme"

A simpler way of defining a mortgage scheme is to reference a proportion of the total assets. We would strongly suggest the Benchmarks should only apply to schemes where a majority of the total assets are intended to be invested in mortgages.

The Draft Regulatory Guide refers to the fact that the Benchmarks apply to responsible entities of unlisted registered mortgage schemes in which retail investors invest directly or indirectly (e.g. through a investor directed portfolio service) [RG000.12]. For the sake of clarity, it would be preferable to specifically state that it applies to circumstances where retail investors invest directly or indirectly through an investor directed portfolio service (IDPS), IDPS like service or superannuation master trust. It should not catch a responsible entity of an unlisted mortgage scheme where retail investors invest indirectly through another registered scheme.

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

Refer to B3Q2

Benchmarks

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

While the IFSA Standard does not concur with all of ASIC suggestions within each Benchmark, it supports them. Please see the specific comments below:

Benchmark 3: Portfolio Diversification

It should be noted that portfolio diversification is a general method of mitigating risk. The inherent risk associated with particular types of real property (commercial, residential etc) will differ as will the overall level of risk due to the specific circumstances of a scheme and the overall risk framework.

Benchmark 7: Distribution Practices

Where a scheme promotes a particular return on investment, we support the disclosure of circumstances in which a lower return may be payable, together with details of how the lower return will be determined,

However there is concern that the other disclosures at RG000.73 involve a degree of supposition or anticipation by the responsible entity in circumstances where it may not be possible for the responsible entity to have reasonable grounds for making those disclosures.

A responsible entity may be able to disclose the source of previous distribution and, if coupled with a warning that the source of distributions in the past is no indication of where they may be sourced from in the future, may not mislead investors.

However, there is concern that statements as to the Responsible Entity's expectations of the source of distributions may result in investors being misled. Instead appropriate disclosure of the risk of non payment of

distributions should be dealt with in the risk section of the PDS for that scheme.

Benchmark 8: Withdrawal Arrangements

Members support the Withdrawal Arrangements Benchmark, however members are concerned that this Benchmark will lead to the duplication of the disclosure of risks in the PDS as some elements of are also likely to appear in the risk section of the PDS.

IFSA members would appreciate some guidance from ASIC in the Regulatory Guide as to whether it expects risk factors covered by the Benchmarks to be repeated or alternatively, whether it is adequate for members to cross refer to the risk section of their PDS.

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

Irrespective of which approach is adopted, a consistent and comparable approach is needed.

On Monday 18 July, 2008, Senator Sherry's (Minister for Superannuation and Corporate Law) issued a prescribed form PDS for the new First Home Saver Accounts (Refer to Corporations Amendment Regulations 2008 (No. 4) Legislative Instrument – F2008L02510). It is noteworthy that section 4 of a sample PDS provided the level of risk disclosure suggested regarding various options (in particular the high risk option 3) was minimalist. This is at odds with the extensive disclosures which may now result from disclosure against benchmarks.

IFSA members support the use of self regulatory tools such as IFSA's Standards to promote best practice industry wide. Self regulation is an important part of the regulatory tool kit; is often able to be more responsive to issues that arise; and builds upon the base line requirements of the legislative and regulatory framework.

By adhering to IFSA's Standards, members demonstrate a commitment to best practice. The industry would welcome ASIC assistance in promoting the Standards more broadly than IFSA's members.

IFSA members believe the most effective way of dealing with the risks and disclosures addressed through the Draft Regulatory Guide would be combination of the Benchmarks and IFSA's Standard.

Question B3Q3: We propose that the following Benchmarks not apply to contributory mortgage scheme:

a) the Portfolio Diversification Benchmark; and

b) certain aspects of the Valuation Benchmarks (eg liquidity benchmark)

also not apply to these schemes? Alternatively, would it be preferable for contributory mortgage schemes to disclose against all the benchmarks?

Benchmark 1: Liquidity

The Liquidity Benchmark should include a section that recognises the difference in liquidity arrangements for contributory mortgage schemes than those for a pooled mortgage scheme. Typically, a contributory mortgage scheme will not permit withdrawals until the underlying mortgage loan is repaid. Where an investor wishes to exit the scheme, it is generally an option, under the scheme constitution, for the Responsible Entity to find a replacement investor/member. This will change the nature of disclosures against liquidity for these schemes.

Benchmarks 5 (Valuation Policy), 6 (Lending Principles), 7 (Distribution Practices) and 8 (Withdrawal Arrangements)

On the basis that a contributory mortgage investment scheme enables an investor to select individual investments with its own fixed term and rate of interest, these Benchmarks may also not be applicable.

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

N/A

Liquidity

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

A Responsible Entity should not be required to hold a minimum amount of assets as liquid assets as the level of actual assets that is appropriate for the operation of a particular scheme will differ, and the liquid assets held will have an impact on the risk and return of the scheme.

The appropriate minimum levels should be determined by the Responsible Entity as it impacts on product construction/innovation which would be constrained by setting minimum levels. It should be noted however that some schemes may have more than 10% in liquid assets.

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

The Liquidity Benchmark requires that a scheme have cash or cash equivalent sufficient to meet its projected cash need of the next 3 months, but proposes to exclude undrawn amounts under bank overdraft or lending facilities. This approach is not considered appropriate and may be overly prescriptive.

Such facilities are often maintained for the purpose of ensuring that a scheme is able to match its current assets and current liabilities, as contemplated by RG000.38. Assets which can be realised in the short to medium term may be matched with readily available credit under credit facilities.

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

While it is necessary for a reasonable estimate of new investment flows to be made when determining scheme liquidity, full disclosures of this may be problematic.

To require a disclosure of this estimate and the 'material' underlying assumptions effectively requires the inclusion of a projection and compliance with s769C and RG 170.

This may necessitate further disclosures of details and information which may be of little practical benefit to investors and involve extensive additional disclosures. It may also require the disclosure of commercially sensitive arrangements in respect of contingent events which do not eventuate.

Finally it may also exacerbate the situation it is trying to avoid by "spooking" existing investors and causing a run on the fund.

The issues associated with assumptions will also need to be addressed. Some of these have been canvassed in Section B of consultation paper (CP) 101 in the context of superannuation forecasts. Paragraph 35 of CP 101 indicates that, "to be as accurate as possible assumptions should reflect conditions at the time the forecast is calculated" and "some assumptions may need to be updated regularly".

Given CP 101, it is also noteworthy that superannuation funds may be investors in various schemes.

We would ask ASIC to draw a distinction between "funding liquidity risk" (due to expected and unexpected current and future cash flow and collateral needs) and "market liquidity risk" (due to inadequate market depth or disruption) and clarify its position regarding disclosure in these distinct but related contexts.

Scheme borrowing

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

The levels of scheme borrowing is a business practice issue and depends on a number of factors – including, but not limited to; overall credit; liquidity and risk management; the nature, duration and terms of borrowing; and the extent to which other forms of financial support e.g. guarantees are available.

We do however consider that a scheme should disclose the existence of any borrowing and the level of borrowing as at a particular date (within ongoing online disclosures).

There needs to be a distinction between borrowing for the purposes of gearing the fund to leverage returns as opposed to the existence of lines of credit or other facilities to assist liquidity management of the fund.

Please note that the Regulatory Guide should clarify what is met by 'on or off balance sheet'. We note that if there is off balance sheet borrowing, it is likely to be the case that assets are also off balance sheet and the inclusion of those borrowed funds could result in a distortion of scheme borrowing disclosure.

Question 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 information be practical for responsible entities?

We do not think that disclosure of probable or likely breaches of loan covenants would be helpful for retail investors.

We consider that this would be impractical for Responsible Entities, and may not give a disclosure to retail investors which indicates the financial health or otherwise of the fund. Further, there would be a degree of prediction in this disclosure which could make it misleading and deceptive to retail investors.

The industry is concerned about the proposed requirement that for each credit facility, the undrawn amount and maturity profile in increments of no more than 12 months be shown. The responsible entity will be unable to obtain such an assurance from its credit provider until the time at which the credit facility is being renewed, this disclosure would at best be based on the responsible entity opinion only and could not be verified.

It is also the case that the undrawn amount of credit facilities will fluctuate significantly, particularly those which are used to provide a fund with short term liquidity.

Any disclosures of this nature would be very difficult to achieve in a simple manner and may actually detract from the objective of clear and concise providing of information in relation to schemes. Moreover, any statement as to

available cash as at a particular date is likely to mislead retail investors as to the cash available under such a facility.

It is also worth noting that the breach of loan covenants could be identified generally as one of the risks.

Portfolio diversification

In relation to paragraph (e) of RG000.51, we consider that disclosure of the proportion of total loan money lent to the largest borrower could result in breach of privacy or commercial confidence, in circumstances where the identity of the borrower may be discernable from the nature of the activities of the particular mortgage trust.

We do not consider that this would be in the interest of members of a scheme. So, consider in circumstances where this would be breach of privacy or commercial confidence or could have adverse impact upon the scheme, the responsible entity should be excused from disclosing against this paragraph of the benchmark.

Similarly, we consider that disclosing by number and value loans where interest has been capitalised (paragraph (j) RG00.52) could also result in there being a disclosure of commercial sensitive information by the mortgage trust which would not be in the interest of scheme members.

Again, there should be recognition in the Regulatory Guide that disclosure of this information should be assessed by the responsible entity and not included where to do so, would not be in the interest of scheme members.

We also note that this level of disclosure is not consistent with that required for other investment vehicles – eg equity fund, and is overly prescriptive. This should not be a mandatory requirement and significantly adds to the disclosure requirements, particularly where a mortgage option is simply one of many within a product.

Valuation policy

We do consider that valuations are an important component of the proper operation of a mortgage trust and we consider it the duty of a responsible entity of mortgage trust to secure objective valuations. However there are concerns regarding the disclosure of those valuations.

Members do not consider that a Responsible Entity should be obliged to disclose a valuation where a loan secured against the property accounts for 5% or more of the total values of the scheme loans book. They do agree that the responsible entity of a contributory mortgage scheme should provide information about the valuation of the loan being offered to an investor.

Valuations frequently contain assumptions and exclusions which affect the interpretation of the valuation. The disclosure of the amount of the valuation

could mislead, unless this other information was also disclosed. This would necessarily involve including the entire valuation in PDS, which may not be possible without the consent of the valuer.

Members have also requested clarification on the following points in relation to the Valuation Benchmark:

- RG000.62 (c) – does this refer to the valuing company or the individual valuer and is the 1/3 determined by the number of valuations or value of security properties or some other measure?
- RG000.63 – does this still apply where the loan is secured by more than one property? e.g. a loan is 6% of the scheme’s loan book but is secured by 10 different properties.

Lending principles

Question B3Q10: Do you think the ratios we propose are appropriate?

The approach taken by ASIC on this Benchmark will essentially lead the regulation of product and fund composition. This is an undesirable step and not consistent with ASIC’s approach to regulation of the industry in other areas.

Risks around Loan to Value Ratios (LVRs) should be addressed through disclosure. Investors may want access to higher returns offered for those loans with higher LVRs.

The approach used within this Benchmark also suggests that risk is homogeneous:

- respectively, across all types property development (commercial residential, industrial etc);
- across schemes that may fall within the definition of a “mortgage scheme” but may have different investment asset mixes;
- across different investment strategies; and
- across all mortgage schemes.

The approach would, for example, mean that no distinction would be made between loans which require security on a first ranking and second or lower ranking basis. It would also mean that a schemes’ overall risk framework and any related schemes or corporate group support e.g. guarantees, are not taken into account.

IFSA does not support ASIC’s prescriptive approach on this Benchmark

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

As per the industry's response to B3Q10, ratios should vary according to the particular circumstances of the relevant scheme.

Distribution practices

Where a scheme promotes a particular return on investment, we support the disclosure of circumstances in which a lower return may be payable, together with details of how the lower return will be determined,

However there is concern that the other disclosures at RG000.73 involve a degree of supposition or anticipation by the responsible entity in circumstances where it may not be possible for the responsible entity to have reasonable grounds for making those disclosures.

A Responsible Entity may be able to disclose the source of previous distributions and, if coupled with a warning that the source of distributions in the past is no indication of where they may be sourced from in the future, this approach may not mislead investors.

However, there is concern that statements as to the Responsible Entity's expectations of the source of distributions may result in investors being misled. Instead appropriate disclosure of the risk of non payment of distributions should be dealt with in the risk section of the PDS for that scheme.

Due to the requirements of RG 170 and s769C, as the Benchmark currently stands it may, and probably will necessitate additional and potentially complex information which may be of limited benefit to investors. It may also require the disclosure of commercially sensitive arrangements in respect of contingent events which do not eventuate.

Further, providing this level of detail is inconsistent with the distribution requirements of other types of assets (eg equities, fixed interest).

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

As per our response to B3Q11, this is likely to require the inclusion of a projection and compliance with s769C and RG 170. It may necessitate further disclosures of details and information. For example, it may entail estimates regarding rollovers which impact on the capital of the scheme. It may also require the disclosure of commercially sensitive arrangements in respect of contingent events which do not eventuate.

We do not consider that the Responsible Entity should be obliged to disclose the expected source of distributions. We consider that a prudent responsible entity would include such risk disclosure in the risk section of the PDS of a matter of course. Regular communication can also be of value in helping members understand changing risks.

Withdrawal arrangements

Members support the Withdrawal Arrangements Benchmark, however members are concerned that this Benchmark will lead to the duplication of risks in the PDS as some elements of these will appear in the risk section of the PDS.

IFSA members would appreciate some guidance from ASIC in the Regulatory Guide as to whether it expects risk factors covered by the Benchmarks to be repeated or alternatively, whether it is adequate for members to cross refer to the risk section of their PDS.

Question 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?

The industry supports the idea that the responsible entity should disclose in the PDS their practice in respect of rollovers and the places where an investor can get updated disclosure before a rollover occurs. Most likely, this will be via a PDS available on a website or enabling an investor to contact the responsible entity to request a fresh disclosure document. We do not think that the method of providing this updated disclosure should be prescribed as different responsible entities will have different disclosure mechanisms in place, having regard to their investor base and the nature of the operations.

For example the Responsible Entity may decide to communicate to investors through online disclosure or other means if necessary. A lack of a response for example should be sufficient to allow the Responsible Entity to rollover. Another option is to ask investors to issue standing instructions in relation to all distributions or allocation of units.

C. DISCLOSING AGAINST THE BENCHMARKS

Upfront disclosure

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

The Regulatory Guide appears contradictory - on one hand it encourages incorporation by reference and streamlining disclosure, but on the other hand it suggests additional PDS disclosures by requiring Responsible Entity's to describe in some detail how benchmarks are met.

The industry is concerned regarding the level of detail that it would be reasonable to disclose within a PDS.

The issue of a PDS is infrequent and ongoing disclosure is better served via online updates as proposed under the IFSA Standard.

Compliance with the Regulatory Guide as it currently stands would result in numerous areas of the benchmarks being out of date shortly after the PDS is issued. Even if this information is clearly dated and there is wording stating that more up to date information is available, investors may rely on out of date information.

The requirement for a SPDS to be issued if a PDS is out of date, will then require the frequent publication of SPDSs.

There is a strong industry preference for the approach detailed within IFSA's Standard. where general statements and policies are referred to in the PDS with all other information included in a 'fund summary' style document that is publicly available. The information contained in this document could be referenced in the PDS.

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

Additional disclosures are justified in circumstances where this disclosure benefits retail investors, however they should have sufficient regard to the clear, concise and effective principles.

To prescribe disclosure against benchmarks in all circumstances creates a risk that the nature, level of detail and complexity of the additional information disclosed may be difficult for some investors to understand, interpret, assimilate and use to assess the nature, benefits or risk associated of an investment in a mortgage scheme.

Some investors may in fact encounter difficulty when attempting to evaluate the additional information or its significance in conjunction or in addition to the other information which may increase investor uncertainty and confusion.

This may result in an investor not understanding or failing to appreciate the significance or impact of other key information. This is arguably contrary to the overriding objective for clear, concise and effective disclosure (Refer RG 175).

It may also reduce the effectiveness with which some investors assess or understand the importance of what is not disclosed or qualified disclosures.

Ongoing disclosure

Question C2Q1: Are there any 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?

Indeed it is considered preferable and necessary for the complex and lengthy disclosures outlined above to be made in ongoing disclosure documentation and online. The six monthly updating in accordance with the obligations under s1017D suggested by ASIC is a reasonable timeframe, however IFSA's Standard does outline that online information should be updated at least quarterly and be accompanied by a date at which the information was correct.

We consider that the ongoing disclosure requirements in the Corporations Act are sufficient to ensure that investors are made aware of material events and significant changes in relation to a scheme.

Clear guidelines here are welcome. If online disclosure can be effectively managed it will serve as a quicker and more efficient form of communication with investors. It may in fact lead to PDS's becoming more fluid.

When you need to disclose against the benchmarks?

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

The timetable for implementing the new disclosure rules from 31st October 2008 is considered unworkable. As already indicated, compliance with the Draft Regulatory Guide as drafted in this timeframe is likely to impose substantial and unnecessary costs on our business.

The system enhancements required to both review, monitor and report against benchmarks will be significant. The additional drafting of fund profiles and additional disclosure, promotional and advertising material and the associated and ancillary amendments required may also be substantial.

Members believe that a more realistic implementation timetable is 30th March 2009.

Some data will need to be manually collated initially (eg details on valuer usage across the portfolio) then system changes implemented to automate data collection.

ASIC should also have regard to the fact that many IFSA members have already been communicating on these issues to clients through their financial planner communications.

D. ADVERTISING STANDARDS FOR ALL MORTGAGE SCHEMES

Question D1Q1: Are there any issues with our proposed timing?

As already indicated, the industry is concerned with the proposed 31st October 2008 commencement date for the implementation of the Regulatory Guide.

The feedback received by IFSA suggests that the proposed timetable will be challenging for most members in that some data will need to be manually collated initially (eg details on valuer usage across the portfolio) then system changes implemented to automate data collection. These system enhancements are required to both review, monitor and report against benchmarks will be significant.

The additional drafting of fund profiles and additional disclosure, promotional and advertising material and the associated and ancillary amendments required may also be substantial.

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

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

It is important that retail investors are not misled when reading an advertisement for a mortgage scheme and the content identified is generally relevant to mortgage trusts.

However there should be a clear distinction between the levels of detail required in a PDS and ongoing disclosures and that which can reasonably be disclosed in advertising and promotional material. It is important that the requirement can be practically applied in all advertising – including newspapers, brochures, on the radio or in some other form. In these instances lengthy additional disclosures can be problematic.

It is important to note that investors are encouraged to read the PDS prior to purchasing an interest in any financial services product and that this should appear prominently within any advertising.

The industry considers that the best protection for investors is that they receive and read a PDS before investing, and that the availability of the PDS be prominently stated in any advertisement.

It has been highlighted that some of the specific requirements may result in important features of a product not being brought to investors' attention.

For instance, it may be the case that a mortgage trust only invests in 'first ranking' mortgages and not to say so would be misleading to investors. The industry therefore considers that, as is currently the case, it should be left to responsible entities to determine what is or what is not misleading or deceptive in a particular situation.

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

Being able to fully utilise online disclosure through incorporation by reference and links to the website will allow the industry to publish more information aimed at investor education. This would enhance disclosure and, dependent upon the form of advertising, may assist the industry in meeting the principles outlined in the Regulatory Guide.

E. COMPLIANCE PLANS, COMPLIANCE COMMITTEES AND COMPLIANCE PLAN AUDITORS

Question 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?

The industry has expressed no real concern regarding compliance plans and it is felt that most plans will not need to be modified to specifically address the benchmarks.

If the form of the compliance plan is one that, for example, refers to an external policy or checklist as the means by which the organisation verifies its compliance with advertising requirements, then it may be the case that the compliance plan does not need modification although other compliance processes need to be changed.

Question E2Q2: Are there any practical problems with the proposed role for compliance committees and compliance committees and compliance plan auditors, and how might this affect Responsible Entities and investors? Please give details.

To the extent benchmarks, additional advertising and disclosure requirements are incorporated into the compliance plan the compliance committee will need to review and monitor compliance with benchmarks.

The protection for investors relates to the ability and duty of the Responsible Entity (its internal processes and framework) and its external service providers to discharge its statutory and fiduciary obligations in accordance with Corporations Act and its constituent documents in the context of the relevant investments, strategy and organisation framework.

This is supplemented by clear, understandable and transparent reporting and disclosure requirements.

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

No comments

Question E2Q4: Should we also require auditors of financial reports to audit: how the responsible entity has performed against the benchmarks or any alternative approach to the benchmarks; and/or for the purposes of the responsible entity's performance against Benchmark 1, the responsible entity's cash flow projections and minimum cash holding?

No, except to the extent the benchmarks are incorporated into the compliance plan but refer to comment E2Q2. Appropriate processes should be evidenced in this area of regulation.

F. INVESTMENT RATINGS

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

Investment ratings can only be considered useful if the details and information provided are understood and can assist an investor to assess a potential investment. In part this will depend on an investor's familiarity and understanding of concepts and terminology used in the ratings reports.

It is also important that the use of terminology is consistent and the information comparable to the information and terminology supplied by issuers.

There is a concern that ratings agencies generally don't understand the underlying credit quality of a mortgage portfolio. They have been caught out in the past recommending a particular mortgage fund only to find the fund failing at a later date.

It's important for both ratings agencies and investors to understand that higher returns can often mean the mortgage fund has invested in riskier loans.

Question 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?

The benefits are that mortgage trusts can be compared on the basis of consistent methodology where a common rating agency used.

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

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

There is no consensus approach to the ratings process and each researcher focuses on different issues, some have a quantitative approach where others a qualitative approach and all use different types of ratings (some use stars, others use words etc.)

This means it is not practical to compare the ratings used by different ratings agencies.

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

There is wide spread agreement that there is a risk that investors will place an undue weighting on an investment rating.

Investment ratings do not take into account the individual investor's circumstances or risk profile. Investors should be encouraged to read all the information available on the product before making a decision or seek professional financial advice.

Question 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?

This is possible, but it is a function of an investor's knowledge and ability to understand the information presented. Refer F1Q1 above.