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Regulatory Issues for Different Asset Classes and Types of Scheme

APEC Financial Regulators
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Today



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- Types of regulatory issue
- Nature and drivers of funds management industry
 - Hedge funds
 - Property trusts
 - Mortgage schemes
 - Primary production schemes
 - Timeshare schemes
 - Complex financial asset schemes

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Types of issue



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For all fund types:

- Unit pricing
- Responsibility for outsourcing
- Independence in governance
- Working with globalisation
- Investing superannuation money
- Regulated or illegal operations

For different assets/schemes:

- Complexity of product > constitution
- Matters to be disclosed > PDS

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Drivers in funds industry



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Australia's funds management industry manages more than A\$814 billion (at December 2004) for over nine million Australian investors, in super and non-super managed investments (unit trusts) and life insurance products.

Over the last 10 years, the investment management industry has become one of the most significant parts of the Australian financial services sector. The Superannuation Guarantee features compulsory employer pension contributions of 9 per cent per annum.

Australia has become one of the major managed funds markets in the world and the largest in the Asia-Pacific outside Japan.

It is anticipated that the managed funds industry will continue to experience high rates of growth, with total funds under management forecast to reach A\$2.3 trillion by 2015.

AXISS 2005

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Different asset classes



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- **Financial assets** – shares, bonds, cash
- **Derivatives** – options, futures
- **Property** – direct and property securities – often includes infrastructure
- **Film** – production and distribution (**tax**)
- **Primary production** – forestry, beef, tea tree oil, emus and ostriches, olives, grapes, coffee, nuts (**tax**)
- **Serviced strata** – management rights
- **Timeshare** – direct and points-based
- **Horse racing** – syndicate
- **Mortgages** – pooled and contributory

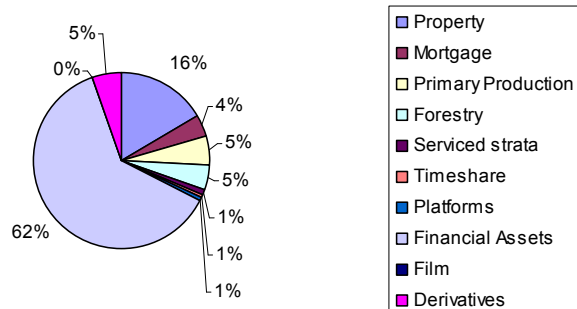
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Proportions: retail schemes



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Types of Managed Investment Scheme



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Proportion: assets in retail schemes

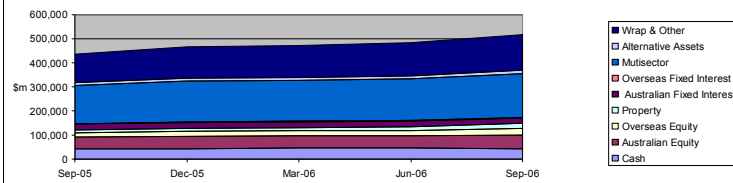


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Retail FUM By Asset Class at 31 December 2006



Retail FUM by Asset Class Over Time



Standard & Poor's Dec 2006

Proportion: assets in wholesale schemes

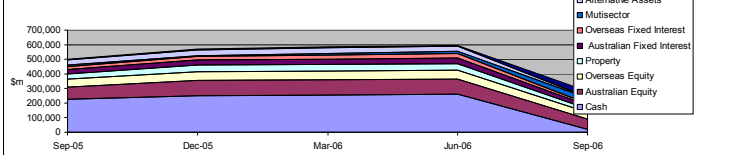


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Wholesale FUM By Asset Class at 31 December 2006



Wholesale FUM by Asset Class Over Time



Standard & Poor's Dec 2006



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Hedge Funds

“Returns uncorrelated with the market”
“Positive returns in all market conditions”

Context



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- **Index funds** – hold to the extent possible the shares held in a particular index, in the same proportions – no research costs
- **Actively managed funds** – performance is still compared to an index but the manager tries to better the index – company research costs of 1-5%
- **Hedge funds** – performance considered in light of risk, not compared with a benchmark

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Industry issues



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- Potential for “style drift” is a concern for fund of fund managers seeking a particular mix of styles for their fund
- “Capacity constraints” and “crowding” both limit growth
- Funds other than hedge funds may adopt hedge fund characteristics – investment styles and use of performance fees

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Regulatory issues



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- Potential impact of trading on the market
- Valuation of illiquid assets > pricing
- Disclosures about, and investor understanding of, investing strategies for funds available to retail investors, including investments by superannuation funds
- Use of votes of borrowed securities
- Potential for conflicts of interest
 - asset consultants also operate funds
 - investment banks offer many services to hedge funds and to other funds

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Property Trusts

Steady income stream from rent
Some risk from property development
Capital growth in value of property

The sector



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- Property trusts have been offered in Australia for more than 40 years
- More than 1M Australians invest
- Almost 70% of investment grade property is held in property trusts (only 12% in USA and 3% in Europe).
- 12% of world's listed real estate is on the ASX
- Regular income of 6-10% pa with capital growth
- Infrastructure has been offered for 10-15 years

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Comparison



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	Australia	Hong Kong	Japan	Singapore	USA
Year started	1985	2003	2000	2002	1960
Legal form	Unit trust	Unit trust	Company	Unit trust or mutual fund	Company
Tax for property income	Exempt	Tax payable	Exempt	Taxed on retained income	Taxed on retained income
Tax for capital gains	Exempt	Exempt	Exempt	Exempt	Taxed on retained gain

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Types of product



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- Direct property – open/closed
- Property securities
- Listed property trusts
- Serviced strata schemes – management rights
- Infrastructure
- Stapled securities

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Types of property asset

- Leisure – hotels, resorts, theme parks
- Retail - shopping centres
- Industrial – warehouses, factories, industrial parks
- Offices
- Retirement villages



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Types of infrastructure asset

May arise from privatisation – global industry:

- Airports
- Water and sewerage facilities
- Car park facilities
- Toll roads
- Railways
- Gas and oil pipelines
- Shipping ports – container terminals
- Power generation/network assets
- Telephone/broadcasting cables/towers



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Stapled securities



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- Typically used for some property and infrastructure trusts
- Two or more shares or units in a trust are held together by contract and can't be sold separately
- Owners receive both dividends and distributions as well as tax consequences of companies and trusts
- There may be ownership benefits – eg management fees are retained and used for the business – however it is harder to replace “internalised” management

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Regulatory issues



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Risk disclosures

- shift from rental to development income
- Increasing offshore investments
 - effect of foreign exchange shifts
 - Security of property title in other countries

Infrastructure

- Percentage ownership of assets

Stapled securities

- Applications for relief – price, related party
- Different takeover law may apply eg if one is a security of a foreign company

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Mortgage Schemes

Funding property development

Development of mortgage funds



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- Many mortgage schemes grew from trust funds – money held by solicitors for clients
- These pools of money could be lent to trusted property developers to earn a rate of return higher than bank returns

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Regulatory issues



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- Recent development of “deposit” marketing – “like a bank” with higher returns
 - Mismatch between timing of deposit withdrawals and timing of returns from property development projects
- Amount loaned compared to value
- Valuation of project at various stages
- Security of property title documents

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Primary Production Schemes

Tax effective schemes

Regulatory issues



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- Impact of size on compliance
- Tax effective schemes:
 - commissions for financial advisers
 - effect on agriculture
- Australian Taxation Office changes:
 - forestry
 - non-forestry

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Timeshare

Property and points-based

Regulatory issues

- Size/experience of issuers
- Level of initial and ongoing financial commitment for retail clients
- High pressure sales to retail clients



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Complex financial asset schemes

Should a product be sold to a retail client?

Regulatory issues

- Can the product be understood by:
 - a retail investor?
 - a financial adviser?
- Are the PDS disclosures clear, concise and effective?



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Questions and Thanks

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More information

<http://www.asic.gov.au/asic/asic.nsf/byheadline/Managed+investment+schemes?openDocument>

<http://www.asic.gov.au/fido/fido.nsf/byheadline/Managed+Investment+Schemes+Home+Page?openDocument>



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