IFSA Standard No. 18.00

Best Practice Guidance for Disclosure in the Mortgage Trust Sector

July 2008

Main features of this Standard are:

- **To establish the parameters of minimum disclosure requirements relating to Mortgage Trusts or Schemes, where a majority of the assets are/or are intended to be Mortgage investments;**
- **To standardise the approach taken by Scheme Managers and Responsible Entities when communicating information about investment policies and the composition of the fund.**
- **To indicate where it is appropriate to disclose this information – the PDS or alternative communication mediums.**

Table of Contents

1.0 Title

This Standard may be cited as IFSA Standard No.18 “Best Practice Guidance for Disclosure in the Mortgage Trust Sector”.

2.0 Background

This Standard replaces IFSA Guidance Note No. 6 "Mortgage Trusts - Disclosure Guidelines" which was last updated in March 2007. The Guidance Note was circulated to members and subject to the comments of a working group and the broader membership before being elevated to an IFSA Standard in June 2008.

3.0 Date of Issue

2nd July 2008

4.0 Effective Date.

If companies are able to, they are encouraged to comply with this standard at the earliest opportunity, however this Standard applies in relation to the PDSs being produced after the 1st January 2010, and to all online and regular member communications being produced after 1st July 2009.

5.0 Application

This Standard should be applied by the Scheme Managers or Responsible Entities for all funds marketed to end investors where a majority of the assets are/or are intended to be Mortgage investments.

This Standard is not intended to replace existing disclosure requirements, but aims to provide best practice guidance on how to disclose features of the investment that are peculiar to Mortgage Trusts so that investors and advisers are easily able to understanding the product risks and the nature of the underlying assets.

Where a Mortgage Trust investment is offered within a product which also contains non-Mortgage Trust investments (for example - a platform product which contains numerous investment options, of which a Mortgage Trust represents only one) and is administered by the same Responsible Entity/Scheme Manager, it is acknowledged the entity will often facilitate disclosure in relation to Mortgage Trust investments as part of the general disclosures applicable to all investment options - and within a single PDS. In these circumstances Scheme Managers/Responsible Entities are encouraged to utilise the ‘Incorporation by Reference’ where suitable, to refer the investor to the information in paragraph 11.0 online. This approach may be preferable in order to maintain the cohesiveness of overall disclosure relating to the product, and applies only if a workable and efficient Incorporation by Reference legislative mechanism exists at the effective date of the PDS requirements of this Standard. For this purpose, this Standard will be reviewed closer to the effective date to ensure suitability.

Where there is a conflict between the requirements of this Standard, applicable legislation, and the Constitution Documents of a Scheme, the requirements of this Standard, having regard to the principles of the Standard, should be modified appropriately so that, as far as practicable, the Scheme Operator complies with the principles of this Standard.

Any Scheme created on or after the Effective Date should comply with this Standard unless such compliance would conflict with applicable legislation.

6.0 Statement of Purpose

- To establish the parameters of minimum disclosure requirements relating to Mortgage Trusts or Schemes where a majority of the assets are/or are intended to be Mortgage investments;
- To standardise the approach taken by Scheme Managers and Responsible Entities when communicating information about investment policies and the composition of the fund; and
- To indicate where it is appropriate to disclose this information – the PDS or alternative communication mediums.

7.0 Application of Materiality

The contents of PDSs for Mortgage Trusts are prescribed, in part, by provisions in the Corporations Act and the Corporations Regulations. PDSs must contain additional information which is known by the directors, promoters and others who authorise or cause the PDS to be issued and which is material to the Scheme member's decision to invest.

In all cases, it is necessary to determine whether any particular information is material. If particular information is material, it should continue to be disclosed in a clear, concise and effective manner. If information is highly material, it should be given prominence. It may well be that for some entities additional information, not referred to in this Standard, is also material and accordingly should be disclosed.

8.0 Definitions

In this Standard:

- 'Associate' has the same meaning as Division 2 or Part 1.2 of the Corporations Act 2001;
- 'Commercial properties' is a generic term and includes offices, retail shops, factories and warehouses;

- ‘Completion value or estimate of end value lending’ means that the estimated profit margin is taken into account in establishing financial exposure limits, this may mean a higher exposure to the underlying loan asset value and a commensurate reduction in the requirement for borrower equity;
- ‘Construction & development properties’ are real properties on which buildings are being constructed. The full value of the property is only realisable upon successful completion of the project and will depend on the project being completed within budget and on time;
- ‘Cost to complete' means that the Scheme Manager only invests against the actual construction costs and retains sufficient funds such that it is able to complete the project;
- ‘Investors’ has the same meaning as in IFSA Guidance Note No. 5.00 ‘Industry Terms and Definitions’;
- ‘Lo Doc’ are where the lender determines eligibility by relying on statements (declaration) by the borrower that they can meet the repayments, rather than requiring documents to prove income, assets and liabilities;
- ‘Loan to Valuation Ratio (LVR)’ is one of the factors lenders consider before they approve a mortgage. This is the loan amount expressed as a percentage of the sworn value of each mortgaged property, based on the valuation of property conducted by a registered valuer approved by the lender;
- ‘Manager’ has the same meaning as in IFSA Guidance Note No. 5.00 ‘Industry Terms and Definitions’;
- ‘Material’ has the same meaning “materiality” as in IFSA Guidance Note No. 5.00 ‘Industry Terms and Definitions’;
- ‘Mezzanine debt’ is where funds are borrowed on a second or subsequent mortgage basis. Mezzanine debt attracts a higher interest rate due to higher risks and in the event of default, will rank behind prior mortgages;
- ‘Mortgage’ is the pledging of property (land and/or a physical structure) to a lender as a security for a mortgage loan;
- ‘Mortgage Trust’ for the purposes of this Standard Mortgage Trust refers to all schemes marketed to end investors where a majority of the assets are/or are intended to be Mortgage investments;
- No Doc’ is where the Lender relies solely on the “Asset” and does not seek any income verification whatsoever nor declaration from the borrower;

- ‘Operator’, in relation to a Mortgage Scheme means the responsible entity of the Scheme;
- ‘PDS’, in relation to a Scheme means product disclosure statement as defined in Part 7.9 the Corporations Act 2001;
- ‘Registered first mortgage’ is the charge over the property securing the payment of the loan. A registered first mortgage is the first charge over the property and must be repaid before any subsequent charge (e.g. a second registered mortgage);
- ‘Related Party Transaction’ has the same meaning as in IFSA Guidance Note No. 5.00 ‘Industry Terms and Definitions’;
- ‘Residential properties’ are houses and apartment blocks; individual units/apartments.
- ‘Scheme’ for the purpose of this Standard is mortgage scheme registered under Part 5C of the Corporations Act 2001;
- ‘Self declaration’ is where the Lender only requires a borrower to provide a ‘self declaration’ form certifying that the borrower believes he/she/ has the capacity to pay interest on a loan as and when it falls due. Self declaration falls under the category of “Lo Doc”; and
- ‘Specialised properties’ are properties built for a specific and specialised purpose such as ,but not limited to, child care centres , aged care facilities, hospitals, service stations, hotels, motels and conference centres. These properties generally require specialist management to run, have configurations which tend to make them unsuitable for alternative use (in their present state), are generally operated as a “going concern” and, therefore, their value is not solely related to the “bricks and mortar” value.

9.0 General Principles and Disclosure Requirements

This 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.

10.0 Context and application in relation to ASIC Regulatory Guide 69.

In elevating this Guidance Note to an IFSA Standard, IFSA has liaised extensively with ASIC. Through their Regulatory Guide 69: Debentures - improving disclosure for retail investors , ASIC used identified benchmarks and ‘if not, why not’ principles for disclosure.

This Standard details the need to disclose against all the benchmarks considered applicable to the Mortgage Trust Sector. These are Liquidity, Loan Portfolio, Related Party Transactions and Valuations. It is recommended that IFSA members apply similar principles for disclosure in relation to the elements of this Standard.

11.0 Specific Disclosures:

11.1 Related Party Disclosures

The PDS should contain a statement which outlines the potential fees, benefits and advantages derived by the Manager and its Associates in connection with managing the Scheme. Where Mortgage Trusts are involved in Related Party Transactions, full disclosure of the nature of such transactions is required.

11.2 Liquidity

The PDS should contain a brief statement which confirms that the Scheme Manager has flow estimates for the next three months; access to enough cash, or cash equivalents sufficient to meet their projected cash needs over the next three months; and has a policy on managing the maturity of their assets and the maturity of their liabilities.

11.3 Mortgage Loan Policies

The PDS should disclose any qualifications or restrictions contained in the Scheme Constitution relating to mortgage loans, which may be entered into. In particular: any related party transaction policies; whether loans are to be secured by first or subsequent mortgages; the upper limit of the LVR; whether loans may be made at fixed interest rates, variable rates or both; and any requirement for mortgage insurance. If mortgage scheme insurance is required by the Scheme Constitution, particulars of the type of mortgage insurance should be fully disclosed.

11.4 Valuation

PDS should include a statement that all valuations are prepared by independent registered valuers, outlining how the value of the assets within the Mortgage Trust was derived. In support of this statement, Scheme Managers should have a clear policy on how often they obtain valuations, including how recent a valuation has to be when they make a new loan. Scheme Managers should have a panel of valuers and ensure that no one valuer conducts more than a third of the Managers valuation work.

Properties should be valued on an ‘as is’ basis. The Scheme Manager should disclose the basis of development valuations i.e. on total development costs, hard costs, on completion or any other method.

11.5 Scheme Borrowing

If relevant, the PDS and annual report should disclose any express provisions in the Scheme Constitution in relation to borrowing associated with the Mortgage Trust - whether for lending, buy-back, redemption or other purposes.

11.6 Buy-back and Borrowings

Both the PDS and annual report to members should disclose the arrangements made by the Responsible Entity to meet the buy-back obligations of the Manager, including disclosures of the liquid assets of and any lines of credit available to the Scheme Manager. Liquid assets would be those that the Manager reasonably expects to realise within the Manager’s buy-back period. Tradable securities and cash should be shown separately from mortgage loans maturing within the buy-back period. Where the Mortgage Trust has access to lines of credit, the amounts available, conditions under which they may be drawn upon and the details of other entities also supported by the Scheme Manager should be disclosed together with current (no later than the last financial quarter preceding the PDS or balance date, where relevant) and proposed liquidity levels of the entities in percentage terms.

11.7 Loan origination fees

Where the Manager or an associate receives fees in relation to arranging or approving the loan, the range of such fees expressed as a %pa of the loan amount, e.g. 'between 0.25 and 1% of the loan amount", should be disclosed in the PDS.

11.8 Investment Policies

To allow Investors the ability to understand the different approaches to the management of Mortgage Trusts, it is important the key approach the Manager will take is accurately disclosed. The PDS should disclose the key features associated with the following:

- an overview of the Scheme Manager's policy on the distribution of the mortgage portfolio according to type of property securing the mortgage loans;
- the maximum percentage of the mortgage portfolio that will be distributed to the following types of assets (as a total or for each type depending on which is deemed most relevent by the

Scheme Manager) - specialised property, vacant land, development land and construction projects;

- an overview of the Scheme Manager's policy on whether the loans will be secured by second or subsequent mortgages or if loans are assigned, in part, on terms which effectively subordinate the rights of the entities to the rights of the assignee;
- an overview of the Scheme Manager's policy on the distribution of the mortgage portfolio in different states and types of locations within States. Scheme Managers should be guided by the location definitions as defined by Standard and Poors';
- an overview of the process for determining borrowers' individual capacity to service the loan. The manager should be specific and indicate, if relevent, the credit assessment process.
- whether or not security properties are required to be income producing, and whether or not loans are made on the security of development projects;
- the proposed use of derivatives, how they are used in the Scheme;
- where a scheme lends or takes security over property developments, or otherwise lends on 'on completion' basis the PDS should disclose both the on completion LVR and the present value LVR (at the date of the advance) to give investors insight to the short and long term risks associated with their investment. The policy regarding the method of valuation should also be disclosed as above; and
- the managers' policy on revaluing mortgaged property upon loan maturity prior to formally renewing and extending the facility.

11.9 Composition of Mortgage Trusts

The exact composition of Mortgage Trusts, while adhering to the investment policies of the Scheme Manager, will not remain constant. It is, therefore, preferable that a broad statement of intent, as per the Investment Policies, be made within the PDS, but that the following information be made available to investors online. The information should be updated at least quarterly and be accompanied by a date at which the information was correct.

The information required is as follows:

- in relation to mortgage loans that are drawn down in more than one tranche, the Scheme Manager should disclose, the value of mortgage loans that have been settled but not utilised or drawn and commitments made that are not yet settled. The Scheme Manager must be able to demonstrate that, at the time of making the loan, they are covered by funds in situ or a standby facility from a recognised financial institution;

- the total number and value of mortgage loans and total number of mortgagors (where mortgagors are related companies, they should be defined as a related mortgagor). They should also disclose any case where more than 5% of the entity's funds have been lent to one mortgagor or related mortgagors the percentage of the fund so lent should be disclosed;
- a statement detailing the sale or purchase of mortgage loans to or from the Scheme during the previous year which resulted in, or were made as a result of, fees, benefits or advantages to the Manager and its Associates in connection with managing the Scheme. The statement should describe each type of service provided, e.g. procuring mortgage loans, and the disclosure of the name of the entity providing the services;
- whether the loans are secured by second or subsequent mortgages or if loans are assigned, in part, on terms which effectively subordinate the rights of the entities to the rights of the assignee. The distribution of the mortgage portfolio between first mortgages, second and subsequent mortgages should be broken down in 5% increments e.g. 60-65%, 65-70%, 70-75%;
- details of the mortgage portfolio LVR on a weighted average basis;
- the distribution of the mortgage portfolio to the following categories: specialised properties, vacant land, development land and construction projects;
- the distribution of the mortgage portfolio in different states. The manager should indicate the criteria used to define which states and territories the manager may provide mortgage loans. Moreover within each state and territory the manager should list the types of geographic locations based on capital city & major urban (ie >250,000 population), major regional (ie population 50,000 to 25,0000) and regional locations (less than 50,000) population (as defined by Standard and Poors' using postcodes or by ABS information);
- the interest rates payable on the mortgage loans in the portfolio in groups of not less than 0.5%. This should be accompanied by a meaningful discursive outlining the Managers Investment Policy on interest rates e.g. where a manager uses fixed rates or swaps to floating;
- the dates, at no later than three monthly intervals for the first year and then annual thereafter, at which mortgage loans included in the portfolio, reach maturity. The manager should specify number and value of mortgage loans in each interval; and
- $ amount, number and % of loans for which principal is overdue for 90 days and more (groupings of 30 days eg 90, 120) and
- $ amount, number and %of loans which are in interest arrears for 60 days and more (groupings of 30 days, e.g. 60, 90 etc.