Investing in mortgage schemes?

Independent guide for investors about unlisted mortgage schemes

This guide is for you, whether you're an experienced investor or just starting out.

AUSTRALIA

ASIC

Australian Securities & Investments Commission

About ASIC

The Australian Securities and Investments Commission (ASIC) is Australia's corporate, markets and financial services regulator. One of our roles is to promote confident and informed participation by investors and consumers in the financial system.

MoneySmart is our website for consumers and investors to help you make smart choices about your personal finances. It offers calculators and tips to give you fast answers to your money questions.

Visit www.moneysmart.gov.au or call ASIC on 1300 300 630.

How can this guide help you?

Read this guide together with the Product Disclosure Statement (PDS) and any other disclosure documents for the investment. ASIC does not endorse specific investments. However, this guide can help you:

Key tips from ASIC about investing

1. Anything you put your money into should meet your goals and suit you.
2. No one can guarantee the performance of any investment. You might lose some or all of your money if something goes wrong.
3. The rate of return offered is not the only way to assess how risky an investment is.
4. 'High return means high risk' is a familiar rule of thumb. However, some investments, even if they seem to offer relatively modest returns, can be extremely risky.
5. Take your time and do your research before deciding what to invest in. Visit ASIC's website for consumers and investors, MoneySmart at www.moneysmart.gov.au, for more information.
6. You are taking a big risk if you put all your money into one investment. Spreading your money between different investment types ('diversification') reduces the risk of losing everything.
7. Consider seeking professional advice from a licensed financial adviser.

Know what the investment is

What is a mortgage managed investment scheme?

A mortgage managed investment scheme (‘mortgage scheme’) uses your money to lend (as mortgage loans) to a range of borrowers who use the money to buy and/or develop properties. It might also be used for other investments (for example, investing in other mortgage schemes).

A company (the ‘responsible entity’) is appointed to run the mortgage scheme on behalf of investors. As an investor, you rely on the responsible entity to manage the scheme.

In return for investing your money (your ‘capital’), the scheme promises to pay you a regular income, usually quarterly or half-yearly (called ‘distributions’). The fulfilment of this promise is conditional on such factors as whether the scheme has sufficient cash to meet distributions.

The mortgage scheme’s income, and your investment returns, depend on factors such as whether the scheme’s borrowers repay their loans and interest on time.

There are three types of mortgage schemes, as shown in the table opposite.

The three types of mortgage schemes

Mortgage scheme type	What is it?
Pooled mortgage scheme	• All investors have a share in all the scheme’s mortgages and investments. • All investors share the income and risks. • Some schemes promote that you can withdraw your money at short notice, but it might take a while (e.g. 12 months) to get it back.
Contributory mortgage scheme	• You or the responsible entity chooses which mortgage(s) you invest in. • Your mortgage(s) might pay a different income from other mortgages in the scheme. • Your risk depends on the quality of the borrower(s) that you or the responsible entity lends to. • Usually, you can only withdraw your money when your mortgage investment matures.
Feeder fund	• You invest money in a scheme that in turn invests all or most of the scheme’s assets in other mortgage schemes. In some cases, the responsible entity should provide you with information on the mortgage schemes in which they invest.

What is an 'unlisted' mortgage scheme?

An unlisted mortgage scheme is not listed on a public market, such as the Australian Securities Exchange (ASX).

There are differences between listed and unlisted mortgage schemes that can make it harder for investors to easily know what's going on with their investment. For example, with an unlisted mortgage scheme:

- you can't see the price of the investment (and whether it is going up or down) and decide to buy or sell when you want to, and
- the scheme is not subject to ongoing supervision by a market supervisor.

ASIC has developed eight benchmarks and eight disclosure principles for unlisted mortgage schemes to help you assess the key risks (see pages 14–37).

What's the difference between a mortgage scheme and other investments?

A mortgage scheme is not the same as a property trust, term deposit or debenture.

How the different investments work

Investment type	How it works
Mortgage scheme	You *invest* money in a mortgage scheme. You might not be able to withdraw from the scheme at short notice. You are not guaranteed a fixed rate of interest or the return of your capital. The scheme invests in residential property and commercial property mortgages.
Property trust	You *invest* money in a property trust. You only get your money back when the property trust ends or if you have a right to withdraw. You are not guaranteed a return on your investment or the return of your capital. The property trust invests directly in property, rather than in mortgages over property.
Term deposit	You *deposit* your money with a specially regulated financial institution such as a bank, building society or credit union for a fixed term in return for a fixed rate of interest.
Debenture	You *lend* your money to a business, usually for a fixed term. You are not guaranteed a fixed rate of interest or the return of your capital. The business might invest in mortgages and/or properties.

Do your research

Before you invest, find out as much as you can about the features and risks of the investment. The responsible entity must give you a Product Disclosure Statement (PDS).

Why is the PDS important?

The PDS tells you how the mortgage scheme works and you should read it in full. Under the law, the PDS must include enough detail for you to compare similar financial products so you can make an informed decision.

Concentrate on the sections in the PDS that:

- explain the key features and risks of the investment
- tell you about the fees you will pay, and
- give you information about certain indicators (or ‘benchmarks’) and disclosure principle information, which can help you assess the risks (see pages 14–37).

This information should be in the first few pages of the PDS. The responsible entity must also tell you when there are significant changes to the information in the PDS (this is called ‘ongoing disclosure’). If you decide to invest in a mortgage scheme, check the scheme’s website and look for regular updates.

What are ‘investment ratings’?

An ‘investment rating’ is an opinion by a research house or research company about the likely performance of an investment, or its relative performance compared to other similar investments. This is different from a ‘credit rating’, which is an opinion about a company’s ability to pay all its debts on time and in full.

An investment rating is only one factor to consider when deciding whether or not to invest in a mortgage scheme. And not all investment ratings are the same:

- Some research houses rate investments with stars (the more stars the stronger the recommendation) and some use words like ‘recommended’.
- The way the ratings are calculated varies. Some research houses only assess investments using publicly available information about the investment (such as price and returns), while others do more in-depth research (for example, speaking directly to the investment managers).
- Many research houses receive payments from the responsible entity promoting the investment being rated.

If you don’t understand how the rating was calculated or how to use it, contact the relevant research house or discuss it with your financial adviser.

Only use ratings from companies that hold an Australian financial services (AFS) licence.

Do you need advice?

Take your time and think things over before you invest. Make sure you do your own research to ensure that you know the risks involved, what exactly happens to your money and whether the investment is really right for you. Get professional advice from a licensed financial adviser if you're not sure what to do.

ASIC's booklet *Getting advice*, available at www.moneysmart.gov.au, can help you understand personal financial advice and what questions to ask your adviser. If you are thinking about investing in a mortgage scheme, or if your financial adviser has recommended such a scheme, make sure you find out the answers to the questions opposite.

The PDS and ongoing disclosure should tell you about the mortgage scheme, what will be done with your money, and the terms of the investment.

A PDS does not have to be lodged with ASIC before it can be used to raise money from investors. ASIC does not check or endorse the underlying investment in a PDS in any way.

Questions you should ask

How does this investment fit into your financial plan and how will it help you achieve what you want?

What are the risks of this type of investment and do you understand them?

What will the mortgage scheme be doing with your money?

Could you explain to a friend or colleague the business model of the mortgage scheme?

Do the anticipated returns justify taking the risks?

Assess the risks

The return offered on an investment is not the only way to assess how risky it is. ASIC has developed eight benchmarks and eight disclosure principles for unlisted mortgage schemes to help you assess the key risks.

The responsible entity should tell you if the mortgage scheme meets each benchmark and provide you with the information set out in the disclosure principles. If a benchmark is not met, the entity should explain why not, so you can decide whether you're comfortable with the explanation.

The responsible entity should also tell you of any significant changes to their performance against the benchmarks and update the information in the disclosure principles (through ongoing disclosure).

Remember

The benchmarks and disclosure principles are not a guarantee that an unlisted mortgage scheme will perform well.

Even if the responsible entity meets all the benchmarks and provides all the information in the disclosure principles, you could still lose some or all of your money if things go wrong.

The benchmarks and disclosure principles are simply designed to help you identify and understand the risks, and decide whether or not to invest your money.

Here's how you can use ASIC's benchmarks and disclosure principles to assess the risks in unlisted mortgage schemes:

Look for information relating to each benchmark and disclosure principle in the mortgage scheme's PDS and ongoing disclosure documents.

Find out if the mortgage scheme meets each benchmark and provides the additional information set out in the disclosure principles.

If a benchmark is not met, does the responsible entity explain why not and how the risk is dealt with in another way?

Are you satisfied with how the responsible entity deals with this risk?

If not, are you willing to risk your money in this investment?

ASIC's 8 benchmarks and 8 disclosure principles for mortgage schemes*

The PDS should tell you whether or not the mortgage scheme meets each benchmark. If the benchmark is not met, the responsible entity should explain why not and how the risk is dealt with in another way.

The responsible entity should also disclose particular information about itself and the mortgage scheme, as outlined in the disclosure principles.

* The benchmarks and disclosure principles apply to unlisted mortgage schemes from 1 January 2013. A PDS issued before that date may include different benchmarks and disclosure.

^ This benchmark or disclosure principle applies only to pooled mortgage schemes.

Benchmark 1: Liquidity

Does the mortgage scheme have enough cash and liquid assets to meet its financial obligations to you and all other parties?

'Liquidity' means a mortgage scheme's ability to meet short-term cash needs. This benchmark applies only to pooled mortgage schemes.

The responsible entity should tell you whether the benchmark is met. The benchmark is met if the responsible entity for the mortgage scheme:

- estimates the scheme's cash needs for the next 12 months ('cash flow estimates')
- can show that the scheme has enough cash or other liquid assets to meet those cash needs ('liquid assets' can be readily converted into cash)
- updates the cash flow estimates at least every three months and ensures that they reflect any material changes, and
- gets directors to approve the cash flow estimates at least every three months.

What's at stake for you?

If the mortgage scheme doesn't have enough cash or liquid assets, there might not be enough money to pay you regular distributions or return your money when you expect it.

As a result of the global financial crisis, many unlisted mortgage schemes had insufficient liquid assets to repay investors at the end of their investment terms, or to allow early withdrawals. In some cases, investors waited several years for their money to be released from 'frozen' schemes.

Before investing in a mortgage scheme, understand the scheme's liquidity and whether this benchmark is met. This will give you a better picture of whether the scheme will be able to pay you regular distributions, and to return your money when you expect it.

Benchmark 2: Scheme borrowing

Does the mortgage scheme have any current borrowings or any intention to borrow?

The responsible entity should tell you whether the benchmark is met. The benchmark is met if the mortgage scheme has no current borrowings or any intention to borrow.

If there are borrowings, the responsible entity should tell you about these borrowings under Disclosure Principle 2 (see page 30).

What's at stake for you?

A mortgage scheme that relies on borrowings is unlikely to be sustainable in the long term. For example, if a mortgage scheme has debts due to be repaid in a relatively short timeframe, this can be a significant risk, especially during times when credit is more difficult and costly to get.

Benchmark 3: Loan portfolio and diversification

Does the mortgage scheme manage risk by spreading the money it lends and invests between different loans, borrowers and investments?

Just as you can spread your own investments to manage risk, a mortgage scheme can manage risk by spreading the money it lends and invests between different loans, borrowers and investments. This is called ‘portfolio diversification’.

This benchmark applies only to pooled mortgage schemes, although diversification is important for all investments.

The responsible entity should tell you whether the benchmark is met. The benchmark is met if the mortgage scheme’s portfolio has the following features:

- assets have different sizes, borrowers, classes of borrower activity and geographic regions
- no single asset is worth over 5% of the scheme’s assets
- no single borrower is loaned more than 5% of the scheme’s assets, and
- loans are secured by first mortgages over real property (for example, land and buildings) – a lender of a first mortgage has priority over other lenders in the event of a default.

What’s at stake for you?

If the mortgage scheme’s portfolio is heavily concentrated in a small number of loans, or loans to a small number of borrowers, there is a higher risk that a single negative event affecting one loan will put the overall portfolio (and your money) at risk.

An example using personal finance

If you put all your eggs in one basket (or all your money in one investment) and something goes wrong, you risk losing everything. Similarly, the risks are higher in mortgage schemes that are not well diversified between different loans and investments.

Benchmark 4: Related party transactions

Do any of the mortgage scheme's transactions involve parties that have a close relationship with the responsible entity?

A 'related party transaction' is a transaction (for example, a loan) involving parties that have a close relationship with the responsible entity.

Before entering into these transactions, the responsible entity must get your approval unless there is an exception under the law (for example, the benefit given to the related party is on 'arm's length' terms). If your approval is required, the responsible entity must set up a meeting where you can vote for or against the proposed transaction. Before the meeting, the responsible entity must give you enough information relating to the proposed transaction so you can judge for yourself how to vote.

The responsible entity should tell you whether the benchmark is met. The benchmark is met if the mortgage scheme does not lend to related parties or to the scheme's investment manager.

If the responsible entity does not meet this benchmark, they should tell you the details, and risks, of these related party transactions under Disclosure Principle 4 (see page 34).

What's at stake for you?

The risk with related party transactions is that they might not be made with the same rigour and independence as transactions made on an arm's length commercial basis. There could be a greater risk of the loans defaulting (putting your money at greater risk) if:

- the mortgage scheme has a high number of loans to, or investments with, related parties, and
- the processes for assessing, approving and monitoring these loans and investments are not rigorous.

An example using personal finance

If you lend money to family members or friends, your loan terms and conditions might be very different from a bank's. You might not expect to get your money back on time or in full. And you are less likely to sue your family or friends for repayment.

Benchmark 5: Valuation policy

How are the mortgage scheme's underlying assets valued?

Knowing exactly how much a mortgage scheme's underlying assets are worth (that is, accurate valuations of the mortgage security) can help you assess the scheme's financial position. But to assess how accurate these valuations are likely to be, you need to know how they're done.

The responsible entity should tell you whether the benchmark is met. The benchmark is met if the mortgage scheme's assets are valued in the following way:

- the responsible entity uses independent valuers that are members of an appropriate professional body where the security property is located
- there are procedures to deal with any conflict of interest
- different valuers are used (for example, rotating the work between a panel of valuers)
- an independent valuation of properties used for loan security is obtained before making or renewing a loan and within two months of directors forming a view of a likelihood that a security property value decrease may have caused a material breach of a loan covenant, and
- if the property used for loan security is a 'property development', the independent valuation is both on an 'as is' basis and an 'as if complete' basis, and for all other property (for example, established buildings) on an 'as is' basis.

What's at stake for you?

Without information about how valuations are done, it is more difficult to assess a mortgage scheme's loan portfolio risks. Keeping valuations up-to-date and ensuring that different valuers are used means valuations are more likely to be accurate and independent.

An example using personal finance

If you've ever sold a house, you know that putting a value on it beforehand is not an exact science – you can only estimate what you think your house might be worth at a point in time. Estimates also vary depending on who is doing the valuation. Valuations are even more difficult and unreliable when they're done before the house is built. Similarly, the way that a scheme's assets and loans are valued is important in determining the scheme's financial position, and the likelihood of income and capital returns for investors.

Benchmark 6: Lending principles – Loan-to-valuation ratios

How does the value of loans made by the mortgage scheme compare with the value of assets used for loan security? Is this proportion too high?

The *loan-to-valuation ratio* tells you the size of a loan as a proportion of the value of the security property for the loan. This ratio is a key risk factor when assessing whether to lend money to someone. A high loan-to-valuation ratio may mean high investment risks for you.

The mortgage scheme may lend for 'property development'. The *loan-to-cost ratio* tells you how much of the total cost of the development is being lent by the scheme to the developer. This ratio helps you assess a developer's incentive to complete the project. A lower ratio means the developer has invested more of their own money in the project, while a higher ratio means the developer has invested less.

The responsible entity should tell you whether the benchmark is met. The benchmark is met if the responsible entity for the mortgage scheme:

- only lends money for the property development in stages, based on independent evidence of the progress made, and
- does not exceed the following loan-to-valuation ratios:

Business activity	Maximum loan-to-valuation ratio
Property development	70% of the latest 'as if complete' valuation
All other types	80% of the latest market valuation

For contributory mortgage schemes, the responsible entity only needs to maintain these loan-to-valuation ratios for the specific loans that relate to your investment.

What's at stake for you?

A high loan-to-valuation ratio means that a mortgage scheme is more vulnerable to changing market conditions, such as a downturn in the property market. Therefore, the risk of losing your money could be higher.

It is important to understand how much of your investment is in loans for property development. The risks involved with development loans are very different from the risks of loans for existing properties that produce an income. For example, there is the risk that the development project will not be completed and the developer may not be able to repay the loan.

An example using personal finance

You might take out a loan for $450,000 to buy a house valued at $500,000 (a loan-to-valuation ratio of 90%). If there's a downturn in the property market when you sell the house and you only get $440,000, you won't have enough cash from the sale to repay the loan. Similarly, when mortgage schemes make loans with high loan-to-valuation ratios, the risks may be increased.

Benchmark 7: Distribution practices

Are current distributions from the mortgage scheme paid from borrowings?

'Distributions' are payments you receive from the mortgage scheme during the year. These payments could come from:

- income received (for example, interest from borrowers)
- borrowings by the scheme, and
- money the scheme receives from selling assets.

The responsible entity should tell you whether the benchmark is met. The benchmark is met if the responsible entity does not pay current distributions from borrowings.

If this benchmark is not met, the responsible entity should tell you the risks associated with paying distributions from borrowings under Disclosure Principle 7 (see page 36).

What's at stake for you?

Some mortgage schemes promise to pay you a regular distribution regardless of whether it actually receives its expected income. Other schemes only pay you regular distributions if they earn enough interest from borrowers and other investments during a particular period.

If a mortgage scheme pays distributions from sources other an income received from its existing loans and investments, this could be unsustainable. This may be particularly important if you are depending on distributions from the scheme for your regular income or for living expenses.

Benchmark 8: Withdrawal arrangements

Can you withdraw from the mortgage scheme and how long will it take to get your money back?

Most contributory mortgage schemes only let you withdraw when the particular mortgage you have invested in matures. On the other hand, most pooled mortgage schemes say that you can withdraw from the scheme at short notice. But in both cases, it might take a while (for example, as long as 12 months) to get your money back.

Mortgage scheme assets are often less readily 'saleable' or 'liquid' than other investments. This could limit when and how you can withdraw from the scheme. Also, each scheme has its own rules (in its constitution) about whether you can withdraw and how long it may take.

'Liquid' and 'non-liquid' schemes

A mortgage scheme offering withdrawal rights may not necessarily have cash readily available to return your money at short notice.

Under the law, a scheme can offer you withdrawal rights if it is a 'liquid scheme' that has at least 80% 'liquid assets'. These assets may include money in an account or in a bank deposit. But liquid assets can also include other property (such as real property, mortgages and investments) if the responsible entity reasonably expects that they can sell them at market value within the timeframe for paying withdrawal requests set out in the scheme's constitution. For example, if the constitution states that your withdrawal requests must be paid within two years, any property that the responsible entity reasonably expects can be sold for its market value within those two years is treated as a 'liquid asset'.

Mortgage schemes that are 'non-liquid schemes' under the law are those that only allow you to withdraw from the scheme if the responsible entity makes an offer to you.

The responsible entity should tell you whether the benchmark* is met. For a 'liquid scheme', the benchmark is met if the responsible entity:

- will pay your withdrawal requests within 90 days and this is stated in the scheme's constitution, and
- only allows you to withdraw from the scheme where at least 80% of the assets are 'liquid assets' of the following type:

Type of asset	How quickly can this asset be converted into cash?
Money held in a bank account or bank deposit	The responsible entity must be able to access this money immediately or within 90 days of the end of a fixed term.
All other types (for example, mortgages and investments in other mortgage schemes)	The responsible entity must reasonably expect that the asset can be sold for its market value within 10 business days.

For a 'non-liquid scheme', the benchmark is met if the responsible entity intends to make withdrawal offers at least quarterly.

* Each mortgage scheme might have a different set of rules for withdrawals, so only parts of this benchmark might apply.

What's at stake for you?

Even if a mortgage scheme says that you can take your money out at short notice, you might have to wait for as long as 12 months to get it back. If too many investors want to get their money out at the same time, the scheme may put a cap on the number of units you can cash out, or it may even freeze all withdrawals. A responsible entity can indefinitely freeze withdrawals if they consider this is in the best interests of members. Before you invest, make sure you can wait for the maximum withdrawal period to get your money back.

If a mortgage scheme's policy is to reinvest your money and you don't withdraw it before it's rolled over, your money might be tied up for longer than you planned.

A 'fixed unit price' might not remain fixed under certain circumstances. This could mean you won't get back the money you expect when you withdraw from a mortgage scheme if the value of the assets falls.

Hardship cases

If withdrawals from your mortgage scheme are frozen, you may be able to access your funds, up to a cap, if you are in hardship (assuming the scheme has enough cash to pay such requests). This would generally only be if:

- you're unable to meet reasonable and immediate family living expenses
- there are compassionate grounds (for example, medical costs for serious illness, funeral expenses, or to prevent foreclosure), or
- you suffer permanent incapacity.

Disclosure Principle 1: Liquidity

Does the mortgage scheme have any significant risks to liquidity and what is the scheme's policy on managing liquidity?

The responsible entity of the mortgage scheme should tell you:

- the scheme's current and future prospects of liquidity and any significant risks that may affect this liquidity, and
- the scheme's policy on managing liquidity (balancing its assets against its debts or 'liabilities'). For example, does the scheme have a policy of ensuring that it holds enough assets that can easily be converted into cash, so future requests for redemptions can be met?

This disclosure principle applies only to pooled mortgage schemes.

Disclosure Principle 2: Scheme borrowing

If there are borrowings, how much has the mortgage scheme borrowed and, for debts due within two years, can the scheme repay/refinance them?

The responsible entity of the mortgage scheme should tell you:

- why they have borrowed the money (including whether the money will be used to pay distributions or withdrawals)
- if they have broken any significant promises made in loan agreements (called 'loan covenant breaches')
- that amounts owing to lenders or other creditors of the scheme rank before your investment
- details of their interest rate and foreign exchange hedging policies and if the scheme's interest rate and/or foreign exchange exposure complies with these policies
- the risks associated with the scheme's borrowings and maturity profile of the credit facility, and
- the following details about their debts:

Debts due in:	What the responsible entity should tell you
Less than 2 years	• total debts due and their maturity profile • the undrawn credit facility (that is, how much can still be borrowed), and • whether refinancing or sale of assets is likely during this period
Between 2 and 5 years	• total debts due and their maturity profile for each 12-month period, and • the undrawn credit facility (that is, how much can still be borrowed)
More than 5 years	• total debts due

You can get a good idea of a mortgage scheme's financial status by knowing:

- how much money the scheme owes and when these debts are due to be repaid (its 'maturity profile'), and
- how much money the scheme can borrow compared to how much the scheme has already borrowed (its 'undrawn credit facility').

Examples using personal finance

Example 1: Maturity profile

You might have a debt that is due to be repaid in two years. If you pay off the original loan amount ('principal') together with the interest, your debt reduces to $0 over the two years.

If you choose an 'interest-only' loan, you only pay the interest part before the debt is due. You would then have to repay all of the principal investment at the end of the two years.

If you didn't have enough money to pay off the principal investment at that time, refinancing your loan to extend the due date would be very important; otherwise, you may default on your debts. A similar risk may apply to mortgage schemes – if it is unable to repay debts or refinance, investors' money could be at risk.

Example 2: Undrawn credit facility

If you have a $5000 limit on your credit card and you have bought $1000 worth of goods with it, your undrawn credit facility is $4000.

Similarly, it's important to know the mortgage scheme's undrawn credit facility because this may indicate that the scheme could become more indebted in the future.

What's at stake for you?

Unless the mortgage scheme can renew or extend the due date of its debts, the scheme might be forced to sell assets (possibly for less than their estimated value) to repay them. The scheme might even have to stop operating. In this case, you could lose all or part of your capital because other creditors of the scheme will be repaid before you.

Disclosure Principle 3: Loan portfolio and diversification

What are the details of the mortgage scheme's investment portfolio and whatht is the scheme's policy on diversification?

The responsible entity of the mortgage scheme should describe the nature of the scheme's investment portfolio, including:

- the loans made by the scheme (for example, the type, location, proportion of loans in default, types of securities, future loan commitments, maturity profiles, loan-to-valuation ratios, interest rates and if the interest is capitalised)
- what proportion of the scheme's loans has been lent to the largest borrower and the 10 largest borrowers
- the proportion of the loans that are secured by second-ranking mortgages
- if any derivatives are used
- any investments by the scheme that are not loans (for example, investments in other mortgage schemes)
- how the scheme goes about lending money in general and its policy on lending (for example, how the scheme assesses the borrower's capacity to repay the loan and how often security properties are revalued)
- the scheme's policy on investing in other mortgage schemes and if those schemes should meet ASIC's benchmarks and apply the disclosure principles, and
- the scheme's policy on diversification.

This disclosure principle applies only to pooled mortgage schemes, although diversification is important for all investments.

Disclosure Principle 4: Related party transactions

If the responsible entity enters into related party transactions, what are the details, and risks, of these transactions and relationships?

If the responsible entity of the mortgage scheme enters into related party transactions, they should tell you:

- the details of the loans, investments and other transactions they have made with related parties (including the number, value and terms of the transaction)
- what relationship they have with the related party
- if they need to get your approval to enter into the transaction and, if so, when
- if they do not need your approval, the reasons why
- the risks of entering into the related party transaction, and
- how they assess, approve and monitor related party transactions.

Disclosure Principle 5: Valuation policy

Where can you get a copy of the mortgage scheme's valuation policy and how often are valuations carried out?

The responsible entity of the mortgage scheme should tell you:

- where to get a copy of the valuation policy (for example, on their website)
- how they decided on the valuation of the security property
- how often valuations are carried out, and
- if there are any important differences between any current valuation and what is disclosed in the policy.

For contributory mortgage schemes, the responsible entity only needs to tell you about the valuations of a property securing a loan if you are being offered an interest in that loan.

Disclosure Principle 6: Lending principles – Loan-to-valuation ratios

What are the details of the mortgage scheme's loan-to-valuation ratios and loan-to-cost ratio (for property development)?

The responsible entity of the mortgage scheme which lends directly should tell you:

- the maximum and 'weighted average' loan-to-valuation ratio for the scheme
- information about any loans made by the scheme that are for property development (for example, how the funds can be drawn down, the stage of completion and the loan-to-cost ratio), and
- if a large proportion of the scheme's investments are loans for property development (for example, more than 20%).

Disclosure Principle 7: Distribution practices

What is the source of distributions from the mortgage scheme and when, and how often, will you be paid?

The responsible entity of the mortgage scheme should tell you:

- the source of the scheme's current and forecast distributions
- if the distributions do not come from income received, the reason they are being paid and whether this will continue over the next 12 months
- the circumstances when a promised return might not be paid to you, and how they will decide on a lower return
- the factors that would have the most impact on the forecast distributions, and an analysis of how changes to those factors could affect the distributions
- what the scheme will do with any excess returns, and
- when distributions will be paid and how often.

Disclosure Principle 8: Withdrawal arrangements

What is the mortgage scheme's policy on allowing withdrawals and how, and when, can you withdraw from the scheme?

The responsible entity of the mortgage scheme should tell you:

- the scheme's policy on allowing withdrawals and whether the responsible entity can change this policy
- if you can withdraw from the scheme and how (for when the scheme is a 'liquid scheme' or a 'non-liquid scheme')
- any significant risks that could stop you getting your money back or within the time you expected
- the scheme's policy on reinvesting ('rolling over') or renewing your money at the end of the initial period (for example, whether this happens automatically)
- if your money will be paid from a loan facility or other external facility, the terms of the facility (for example, can the lender at any time suspend or cancel the loan facility?)
- the longest period of time you might have to wait before you can get your money back
- any rights of the responsible entity to refuse or suspend withdrawal requests
- the scheme's policy on balancing its assets against its liabilities
- if the responsible entity makes statements about your ability to withdraw from the scheme in the future, the reasons that support this and any risk that you won't be able to withdraw, and
- if the scheme promotes a fixed withdrawal price (for example, at $1 per unit), the circumstances where that price could change.

For contributory mortgage schemes, the responsible entity only needs to tell you this information if you can withdraw from the scheme before your mortgage investment matures.

Think about your own situation and needs

Does the investment meet your goals?

Whenever you invest your money, it is important to have a financial goal in mind, and a strategy for achieving it. For example, your goal may be a secure income for your retirement.

Think about getting professional advice from a licensed financial adviser to help you develop a suitable investment strategy according to the level of risk you're comfortable with. Then measure all investments against that strategy.

Is it important to you to protect your capital?

Be careful about words like 'safe' and 'guaranteed' in advertisements. They might imply that an investment is secure, when in reality it is not.

Certain financial institutions like banks, building societies or credit unions are specially regulated by the Australian Prudential Regulation Authority (APRA) to make sure that, under all reasonable circumstances, they can meet their financial promises to you.

This type of regulation, called 'prudential regulation', protects you, for example, if you put your money in a term deposit with one of these institutions.

Have you spread your investments to manage risk?

Most people have heard the saying, 'Don't put all your eggs in one basket'. When it comes to investing your money, a good way of managing risk is to spread your money between different investment types, such as cash, fixed interest, property and shares. The spread will depend on your financial goals and how much risk you're comfortable with. These different investment types are known as 'asset classes'.

Spreading your investments to manage risk is called 'diversification'. Investing solely in unlisted mortgage schemes is not diversification.

By spreading your money both across different asset classes and between different investments within the same asset class, you reduce the risk of losing everything. If you put only part of your total funds into any one type of investment, you won't lose everything if one investment produces poor results or fails completely.

What returns are you being offered?

'High return means high risk' is a familiar rule of thumb. However, as with all rules, there are exceptions to look out for.

Some investments that appear to offer relatively modest returns can be extremely risky. That's why it's important to think about more than just the return when deciding whether to invest.

When comparing rates of return, make sure you compare 'apples' with 'apples' (that is, similar investments).

Can you get your money back early?

If you plan to invest in an unlisted mortgage scheme, consider what will happen if you need to get your money out quickly. Are there penalties or restrictions? How long might you have to wait?

If you need flexibility, think about investing in other financial products that allow you to withdraw your money without significant penalties or significant delays.

Do you know how risky the investment is?

Investing in unlisted mortgage schemes is riskier than term deposits offered by banks, building societies and credit unions that are prudentially regulated in Australia (see page 7 to compare these investments).

Ask whether the return you are being offered is high enough to compensate you for the risks you are taking.

Can you accept the risks?

A primary risk with an unlisted mortgage scheme is that the scheme might not generate enough cash flow to meet its costs and debt repayments, and be unable to pay you distributions or return your money when you ask for it.

If you don't understand these risks or you're not comfortable taking any risks with your money, look at other financial products instead. Get professional financial advice if you're not sure about an investment decision.

Do you know what you're investing in?

If you're investing in an unlisted mortgage scheme, check what the responsible entity plans to do with your money. This information should be clearly set out in the PDS, but keep asking questions until you really understand.

Knowing what your money will be used for and what the responsible entity has invested in previously can help you assess the risks and decide whether you are comfortable with the investment.

Is the investment related to property development?

If your money will be used for property development (not established properties), think about these extra risks:

- Will the property development be completed on time and on budget?
- How is the property development valued?
- How will the mortgage scheme meet its cash flow needs before the property development is completed and sold?

The PDS should help you answer these questions.

> People like to think that investing in property is as 'safe as houses'. In reality, it involves risk like any other investment – the risk of losing your money.

Misleading advertising? Hard sell?

Have you come across an advertisement for a financial product that you think is misleading?

Or have you been pressured by a salesperson to make a decision when you didn't have enough information, or weren't sure that the product was right for you?

Phone ASIC on 1300 300 630 to tell us about it.

Go to www.moneysmart.gov.au for:

- strategies to help you avoid sales pressure
- information about how to complain, and
- what to look for when investing.

Remember:

- The benchmarks and disclosure principles are not a guarantee that an unlisted mortgage scheme will perform well.
- Even if an unlisted mortgage scheme meets all the benchmarks and provides all the information set out in the disclosure principles, you could still lose some or all of your money if things go wrong.
- Any investment should meet your goals and suit you.
- ASIC does not endorse specific investments.

ASIC's benchmarks and disclosure principles can help you*

The benchmarks and disclosure principles are designed to help you:

- understand the risks, and
- decide whether to invest your money.

* The benchmarks and disclosure principles apply to unlisted mortgage schemes from 1 January 2013. A PDS issued before that date may include different benchmarks and disclosure.

^ This benchmark or disclosure principle applies only to pooled mortgage schemes.