

11 September 2015

**MEMORANDUM TO DIRECTOR OF PRIMARY MARKETS AND INVESTOR RESOURCES**

**FINANCIAL MARKETS CONDUCT ACT EXEMPTION – FIRST MORTGAGE TRUST GROUP INVESTMENT FUND AND FIRST MORTGAGE PIE TRUST**

**Purpose and summary recommendation**

1. This memorandum recommends exemptions from certain provisions of the Financial Markets Conduct Regulations 2014 (**FMC Regulations**) be granted to First Mortgage Managers Limited (**Manager**) as manager of the First Mortgage Trust Group Investment Fund (**First Mortgage**) and First Mortgage PIE Trust (**FM PIE Trust**) in relation to the regulated offers of managed investment products in First Mortgage and FM PIE Trust, respectively (the **Offers**).
2. The proposed exemptions are from clause 53(1)(c)(viii), clause 53(1)(j) and clause 70(1)(a)(i) of Schedule 4 of the FMC Regulations. In particular, from the requirement contained in those clauses that information regarding the 'name of the individual asset' be included in:
  - (a) the list of the 10 highest-value individual assets of First Mortgage and FM PIE Trust required in the register entry for each Offer and in each quarterly fund update for First Mortgage and FM PIE Trust; and
  - (b) the complete list of the individual assets of First Mortgage and FM PIE Trust required in the register entry for each Offer.
3. The conditions of the exemption will require alternative information to be provided in the register entry for each Offer and in each fund update.
4. We attach a notice to put the recommended exemptions into effect should you agree to grant them. If you agree to grant the exemptions please execute the notice and initial each page. We confirm that the FMA's procedure for consideration of exemption applications and preparation of exemption notices has been followed, including peer review of the notices and this memorandum. We have reviewed the notice and are satisfied that it is accurately drafted to give effect to the decision we recommend in the memorandum and that they reflect the reasons for that recommendation.
5. We seek a decision as soon as possible to enable First Mortgage and FM PIE Trust to supply to the Registrar all the information for the respective Offers that the register entries are required to contain by 14 September 2015.
6. We confirm that, as Director of Primary Markets and Investor Resources, you have delegated authority to consider and grant the exemptions contained in the notice.



## Background

7. The Manager is a licensed manager under the Financial Markets Conduct Act 2013 (**FMC Act**) and is the manager of First Mortgage and FM PIE Trust.
8. First Mortgage is an externally managed designated group investment fund under the Income Tax Act 2007 and is a managed fund for the purposes of the FMC Act. First Mortgage pools the funds received from investors and invests those funds in loans secured by first mortgages over property (**Mortgage Loans**), as well as deposits with registered banks.
9. FM PIE Trust is also a managed fund under the FMC Act. Essentially, FM PIE Trust is a 'fund of funds' as it pools the funds received from investors and invests those funds solely in First Mortgage.
10. For each of the Offers, the Manager has been in the process of preparing a product disclosure statement (**PDS**) and information for the register entry (**Register Entry**) to be lodged with the Registrar in accordance with the requirements of Schedule 4 of the FMC Regulations. First Mortgage and FM PIE Trust have elected an 'effective date' of 14 September 2015 to transition from the Securities Act 1978 regime to the FMC Act regime and as a result, First Mortgage and FM PIE Trust intend to lodge the PDS and Register Entries with the Registrar on 14 September 2015.
11. As managed funds under the FMC Act, First Mortgage and FM PIE Trust are required to provide the following information:
  - (a) a list of the ten highest-value individual assets of First Mortgage and FM PIE Trust including, among other things, the 'name of the individual asset' in both the Register Entries and each quarterly fund updates (**Fund Update**) required to be prepared by the Manager for First Mortgage and FM PIE Trust and made publicly available in accordance with the FMC Regulations; and
  - (b) a complete list of the individual assets of First Mortgage and FM PIE Trust in the respective Register Entries and against that list for each individual asset, information regarding the 'name of the asset' must be provided.
12. Under clause 70(2) of Schedule 4 of the FMC Regulations, if any part of a fund is invested in a related underlying fund, the fund must treat the individual assets of that underlying fund as if they were the individual assets directly held by the fund. FM PIE Trust is invested solely in First Mortgage which is a related underlying fund of FM PIE Trust. Therefore, in accordance with clause 70(2) of Schedule 4 of the FMC Regulations, FM PIE Trust must treat the assets held by First Mortgage as if they were the assets directly held by FM PIE Trust.
13. The 'assets' that First Mortgage invest in are the Mortgage Loans and the cash deposits held by registered banks. It appears the intention of the requirement to provide the name of each individual asset is that the information must be sufficient to identify that asset. The most understood and accepted way to give a 'name' to a financial product would be by reference to the name of the issuer. Accordingly, in the case of Mortgage Loans, the name of the asset would need to include the name of the borrower under the respective Mortgage Loan (i.e. the issuer of the debt security).
14. The Manager considers that, in relation to Mortgage Loans, including the name of the borrower would not provide meaningful information for investors. Instead, the Manager



proposes to provide alternative information for the 'name of the individual asset' where that information is required in the Register Entry or the Fund Updates.

#### Exemptions sought and conditions proposed

15. The Manager seeks an exemption from the following clauses of Schedule 4 of the FMC Regulations in relation to the Offers:
- (a) clause 53(1)(c)(viii) which requires the Register Entries to include a list of the 10 highest-value individual assets of First Mortgage or FM PIE Trust and the information required by clause 70(1)(a) and (b) of Schedule 4 of the FMC Regulations (which includes the 'name of the individual asset');
  - (b) clause 53(1)(j) which requires the Register Entry to include a complete list of individual assets of First Mortgage or FM PIE Trust and, against that list, information including the 'name of that asset; and
  - (c) clause 70(1)(a)(i) which requires First Mortgage and FM PIE Trust to include the name of each individual asset in the list of the 10 highest value individual assets in each Fund Update.
16. The Manager has proposed that the exemptions be subject to the condition that the Register Entries and each Fund Update for First Mortgage and FM PIE Trust contain the following information regarding the 'name of the individual asset':
- (a) if the individual asset is a Mortgage Loan, instead of disclosing the 'name of the individual asset', the Register Entry or Fund Update must contain the registered mortgage number of the secured property<sup>1</sup>, a description of that property as either residential, commercial or rural, and the geographical region within New Zealand that secured property is located; and
  - (b) if the individual asset is not a Mortgage Loan, the name of the individual asset as per the FMC Regulations;
17. The Manager has also proposed that the Register Entries and each Fund Update for First Mortgage and FM PIE Trust contain the following additional information:
- (a) the composition of First Mortgage's assets expressed as a percentage according to the following asset types (**Asset Types**):
    - (i) Mortgage Loans for which the secured property is residential property;
    - (ii) Mortgage Loans for which the secured property is commercial property;
    - (iii) Mortgage Loans for which the secured property is rural property; and
    - (iv) cash deposits held with registered banks;

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<sup>1</sup> In a small number of cases Mortgage Loans are secured by more than one property, in which case details of the principal secured property (by value) will be provided. References to 'the secured property' refer to this principal secured property.

- (b) the composition of Mortgage Loans expressed as a percentage according to each geographical region of New Zealand and within each geographical the region details of the proportion of Asset Types;
  - (c) details regarding the value of impaired Mortgage Loans (if any) and the composition of those impaired Mortgage Loans expressed as a percentage according to each geographical region and each Asset Type;
  - (d) a clear, concise and effective statement by the Manager describing the criteria used by First Mortgage for determining which of its Mortgage Loans fall within each Asset Type; and
  - (e) A table setting out the maximum Loan to Value Ratio for each type of Mortgage Loan (i.e. residential , commercial or rural) as at the date of advance of that loan.
18. The proposed conditions also specify that the information (other than the name of the individual asset) about the individual assets of First Mortgage and FM PIE Trust required by clauses 53(1)(c)(viii) and 53(1)(j) and of Schedule 4 of the FMC Regulations must still be included in the Register Entries.
19. The Manager has advised that, in its view, the name of the borrower under the relevant Mortgage Loans does not provide meaningful information. The names of individual borrowers, family trusts and corporate borrowers have no materiality for investors. Instead, the Manager considers that the interests of investors would be best served by disclosing information such as a description of the property secured by the mortgage, the geographical location of that property, the composition of First Mortgage's assets according to asset type and geographical location, and the details regarding the value of any impaired Mortgage Loans and composition of those loans according to each geographical region and asset type. The Manager believes that this information is more useful to investors, and provides investors with the information they need to make an informed decision in relation to the risk profile of the assets that First Mortgage and FM PIE Trust invest in.
20. In addition, the Manager is reluctant to disclose the names of individual borrowers under the Mortgage Loans as information which is personal and relates to the borrower is protected from disclosure by the Privacy Act 1993 (**Privacy Act**). The Manager considers that requiring the disclosure of the names of individual borrowers may potentially put the Manager in breach of its obligations under the Privacy Act.

#### **Our comments**

21. The policy intention behind the requirement to disclose a managed fund's portfolio holdings is to increase the ability of investors to monitor the investment practices of fund managers to assess whether they are consistent with the fund's investment philosophy, and to assess the investor's level of exposure to risk. However, it appears that this rationale was aimed primarily at managed funds that invest in the more traditional liquid market assets such as bonds and shares. Disclosure of the name of the issuer for these types of assets is useful information for investors as there is often publicly available information that can assist an investor to assess the risk profile of those assets that a managed fund invests in.
22. We agree that disclosure of the name of the borrower under the Mortgage Loans would not provide meaningful information that would assist an investor to assess First Mortgage's or FM PIE Trust's investments. It would be unlikely that an investor would be able to assess the credit risk of a significant number of individual borrowers or even corporate borrowers,



given that there is likely to be very little or no publicly available information on those borrowers.

23. We agree that the proposed alternative information in respect of the Mortgage Loans to be included in the Register Entries and each Fund Update will provide investors with more meaningful information to assist them assess First Mortgage's and FM PIE Trust's investments.
24. We also consider that it would not be desirable for First Mortgage or FM PIE Trust to disclose the names of individual borrowers under the Mortgage Loans in the Register Entry and Fund Updates. Notwithstanding that disclosure could potentially put the Manager in breach of its obligations under the Privacy Act, this is personal information that individual borrowers are unlikely to want made public.
25. Finally, we note that this issue was raised and discussed at the Regulatory Policy Committee on 26<sup>th</sup> August 2015. No decision was sought from the committee as no paper had been produced, but none of the committee objected to Primary Markets proceeding with considering the merits of an exemption and the terms on which it might be granted.

### **Recommendation**

26. We **recommend** that FMA grant the Manager exemptions from clauses 53(1)(c)(viii), 53(1)(j) and 70(1)(a)(i) of Schedule 4 of the FMC Regulations, in connection with the proposed offers of managed investment products in First Mortgage and FM PIE Trust.
27. We **recommend** these exemptions be subject to conditions discussed in this memorandum and reflected in the attached exemption notice.

### **Reasons**

We consider that it is appropriate to grant the exemptions because—

- the intention behind the requirement to disclose a managed fund's portfolio holdings is to increase the ability of investors to monitor the investment practices of fund managers to assess whether they are consistent with the fund's investment philosophy, and to assess the investor's level of exposure to risk. However, the disclosure of the name of a borrower under a Mortgage Loan would not provide meaningful information that would assist an investor to assess First Mortgage's or FM PIE Trust's investments:
- the names of individual borrowers under the Mortgage Loans is personal information that is protected by the Privacy Act. The requirement to disclose the names of the individual borrowers in the Register Entry or Fund Update may potentially put the Manager in breach of its obligations under the Privacy Act:
- the conditions of the exemption require that for any Mortgage Loan, instead of disclosing the 'name of the individual asset', the Register Entry or Fund Update must contain the registered mortgage number, a description of the secured property as either residential, commercial or rural, and the geographical region that the secured property is located:
- the conditions of the exemption also require the Register Entry or Fund Update to include additional information such as the composition of First Mortgage's assets according to specified asset types, the composition of Mortgage Loans according to geographical region, details regarding the value of impaired Mortgage Loans (if any) and the composition of those impaired Mortgage Loans expressed as a percentage according to each geographical region

and specified asset type, to help investors assess First Mortgage's and FM PIE trust's investments:

- as such, the FMA is satisfied that the granting of the exemptions is desirable in order to promote one or more of the purposes of the Act, specifically to promote the confident and informed participation of businesses, investors, and consumers in the financial markets and to provide for timely, accurate and understandable information to be provided to persons to make decisions relating to the financial products:
- the exemptions only provide relief from the requirement to provide information regarding the 'name of the individual asset' for Mortgage Loans which is considered not meaningful, and imposes conditions which require the provision of alternative and more relevant information on the Mortgage Loans in the Register Entries and Fund Updates. In these circumstances, the FMA considers that the exemptions are not broader than reasonably necessary to address the matters that give rise to the exemptions.

Blair Horner  
Senior Solicitor

**Decision**

Accept/Decline recommendation



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Simone Robbers  
Director of Primary Markets and Investor Resource  
Financial Markets Authority

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Date 11/9/15

