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TREASURY EXECUTIVE MINUTE

Minute No.

14 October 2010

Assistant Treasurer and Minister for Financial Services and Superannuation cc: Treasurer

MEETING WITH sub-paragraph 22(1)(a)(ii) (not relevant)

Timing: The meeting with Lazard is scheduled for 10am on 15 October.

sub-paragraph 22(1)(a)(ii)
(not relevant to request

- You have requested background briefing for this meeting on:

  sub-paragraph 22(1)(a)(ii)
  (not relevant to request)

  – Developing the corporate bond market in Australia (at Attachment D); and

  sub-paragraph 22(1)(a)(ii)
  (not relevant request)

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Pages 2 to 6
Sub-paragraph 22(1)(a)(ii)
(not relevent to request)

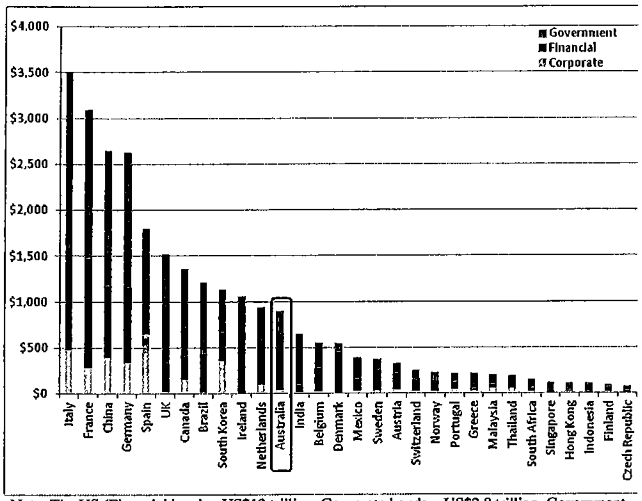
ATTACHMENT D: DEVELOPING THE CORPORATE BOND MARKET

State of the Australian Corporate Bond Market

Although the total size of Australia's debt market is significant, its composition is substantially different to other countries. In particular, Australia's corporate bond and government bond markets are smaller, and its market for bank bonds is larger. This partly reflects the Australian Government's relatively low budget deficits and Australian corporations' traditional reliance on bank loans instead of market-based debt.

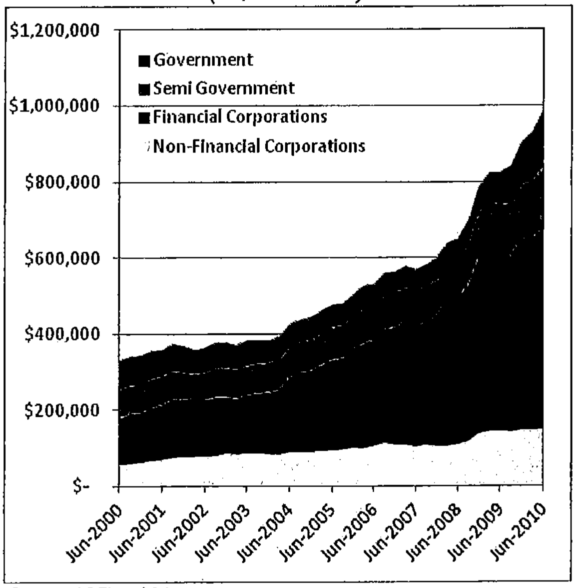
Over the past decade there has been a substantial increase in the value of bonds issued by Australian financial corporations, although the majority of these bonds are issued in offshore markets.

Domestic debt securities issued
(March 2010, US$ billions)



Note: The US (Financial bonds - US$12 trillion, Corporate bonds – US$2.8 trillion, Government Bonds US$10 trillion) and Japan (Financial bonds - US$1 trillion, Corporate bonds – US$746 million, Government Bonds -US$10 trillion) are not included in the graph. Source: BIS 'The International Banking Market – Table 16b.

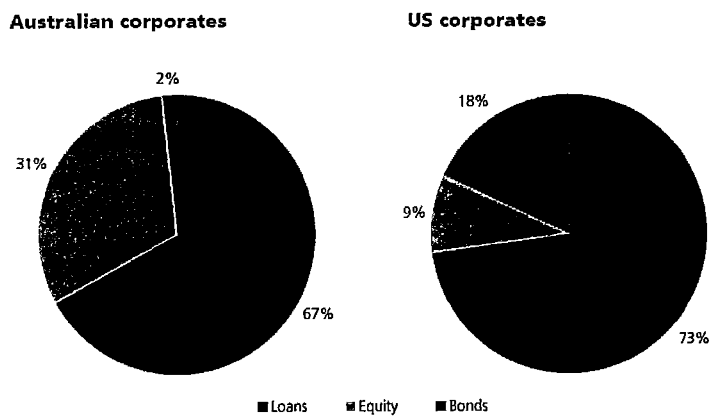
Bonds issued by Australian entities
(A$ million)



Source: ABS Financial Accounts

In comparison with the US, Australian corporations source a much lower proportion of capital from the debt markets. In part, this is a result of the ability of Australian banks to adequately serve the credit needs of the corporate sector at competitive rates, a lack of demand for fixed income securities, and uncompetitive pricing domestically compared with alternatives such as offshore markets or bank credit.

Comparison of funding sources for Australian and US Corporations *(average 2005-09)*



Source: UBS Australia, 2010.

- ASIC has announced new arrangements for simplifying prospectus requirements for listed bond issuance. These provide relief from 'long form prospectus requirements', including:
  - : a shorter prospectus which would be focussed on the details of the particular bond offer and the ability of the bond issuer to meet its repayment obligations; and
  - : a two-part prospectus designed to provide greater flexibility and speed-to-market in making successive bond offers.
  - – Only one corporation (Primary Health Care) has sought to use this relief at this time, although media reports suggest additional companies are considering this option presently.
- On the demand side, the Government has announced a tax discount on interest-bearing investments.
  - – From 1 July 2012, Australians will be able to obtain a 50 per cent tax discount for the first $1,000 of interest earned on deposits held in banks, building societies and credit unions, debentures and annuity products, and bonds.
  - – This is expected to increase demand for interest-bearing investments (including bonds) and have positive flow on effects for competition generally in the financial system.

Further Options – Wholesale Level

With regard to further policy options to stimulate the market, the Johnson report concluded that *"at the wholesale level, there is little that the Government could do to encourage institutional demand for corporate bonds."*

- For example, in relation to supply, Australian corporates have traditionally been well served by the Australian banking system, with bank credit typically being viewed as a cheaper and more flexible source of funding than corporate debt issuance.
- Similarly, in relation to demand, the defined contribution schemes favoured by most superannuants in Australia may provide an incentive for superannuation funds to invest in growth assets such as equities. In contrast, the defined benefits schemes more prevalent in America and Europe may provide an incentive for fund managers to match their liabilities with investments in corporate bonds and other fixed interest assets. Australia's dividend imputation system may also provide an incentive for investors to invest in equity instead of debt securities.

Further Options – Retail Level

Trading CGS on Retail Market

- Industry representatives, including the ASX and the G100, have argued that trading CGS is required to 'kick-start' the retail corporate bond market. Industry has suggested that trading CGS would raise retail investor interest and confidence in the corporate bond market and potentially encourage retail demand for non-government corporate bonds. If accompanied by an educational campaign to retail investors, the G100 has argued it could have a similar impact as the CBA & Telstra floats had for the equity market.
  - – Industry has also suggested that retail CGS issuance would also provide a pricing benchmark for a 'risk-free' retail debt instrument, which would assist the market in pricing other retail corporate bonds.

Pages 11 and 12 exempt under
sub-paragraph 22 (1)(a)(ii)
(not relevant to request)