



10 February 2012

Manager, Financial Services Unit
Retail Investor Division
The Treasury
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Dear Sir/Madam

Development of the retail corporate bond market: streamlining disclosure and liability

This submission is made on behalf of Australia Ratings Pty Limited ("Australia Ratings") in response to the above discussion paper dated December 2011.

We thank you for the opportunity to submit comments on the discussion paper and for the opportunity to participate in the consultation meetings conducted to date by Treasury on its objectives of promoting the development of a retail debt market.

Australia Ratings was established in July 2010 and holds a retail Australian Financial Services Licence ("AFSL") to issue credit ratings to debt securities and financial products offered in the Australian financial market. Australia Ratings supports the Government's desire to foster a more vibrant and liquid retail bond market as part of further developing Australia's financial markets and in particular the debt capital market. Retail corporate bonds have an important role to play in providing an alternative funding source for Australian corporate borrowers and also providing income yielding securities as part of Australia's retirement income sector.

Our submission is in two parts; in the first part we make some general comments and in the second part we address the specific questions raised in the discussion paper where we believe it is appropriate for us to comment. We would be pleased to discuss or answer any questions you may have on our response.

Yours sincerely

Chris Dalton
Managing Director

1. General Comments

- Australia Ratings believes to further develop the retail bond market in Australia it is necessary and appropriate for the disclosure requirements for a retail bond issue to be aligned with those of a share entitlement offer. The process of a company raising debt through the issue of vanilla bonds from retail investors should be no more onerous in terms of disclosure than the process of raising equity from retail investors. The key in both cases is for retail investors to be given adequate, relevant and understandable information for them to be able to make a confident and informed decision in relation to the offered investment.
- Australia Ratings rejects the criticism of the licensing of credit rating agencies ("CRAs") implied in the comment point 34. . Australia has a clear two level licensing regime that applies to CRAs and there is no regulatory restriction to the provision of credit ratings to retail debt issues. The requirement for a CRA holding a retail licence to be a member of the Financial Ombudsman Scheme provides protection to a retail investor. Australia Ratings believes this policy supports both informed and confident investors.
- Australia Ratings believes a retail bond market will be enhanced by the Commonwealth Government maintaining bond issues in the market with various terms to provide a pricing benchmark for retail issues.
- We are also of the view that advances in technology should be utilised to enhance the execution of vanilla bond issues to allow direct application and issuance by corporates via the internet.

2. Specific Responses

Should the short form prospectus be compulsory for issuers and bond issues that meet the eligibility requirements set out below, or should it be optional?

The development of a retail bond market will be aided by retail investors being presented with consistent offering documents of a similar format. It is therefore recommended that a short form prospectus be mandated for all bond issues that meet the eligibility requirement.

Should the use of a two-part prospectus be permitted?

Australia Ratings believes a two-part prospectus will make the issuance of retail corporate bonds more efficient for an issuer and appropriate for vanilla corporate bonds. The base prospectus should have a medium term life of say up to three years which could be supplemented by a term sheet and cleansing statement when a company wishes to issue a further vanilla bond.

Conditions related to the issuer: Are these proposed conditions appropriate? Are there any additional or alternative conditions that should be imposed?

The proposed conditions are appropriate.

Should unlisted entities with listed securities on issue be allowed to use the shorter prospectus? If so, what, if any, additional requirements would need to be imposed to ensure that investors are informed about the entity's financial position?

We believe that a total exclusion of unlisted entities is overly restrictive and not appropriate. We suggest consideration should be given to allowing unlisted issuers to benefit from using a shorter form prospectus subject to certain conditions which could include the entity being regulated by APRA or another regulatory body, providing at least annual audited financial reports to investors and by having the issue rated by a credit rating agency.

Should eligibility extend to a wholly-owned subsidiary of a body which has continuously quoted securities where the business of the subsidiary is to act as a financing company for the group?

This may be appropriate where the subsidiary is wholly owned and is guaranteed by the parent company.

- Is the requirement for an unmodified auditor's report appropriate, or is it:**
- (a) inconsistent with audit requirements in other contexts where unmodified reports are not necessary?**
 - (b) unnecessary, as some modifications may be positive?**
 - (c) unnecessary because, if the report is modified, investors will have access to the modified report in order to make an assessment of the relevant issues?**

Investor confidence will be enhanced if the issuer of the bond has been given an unmodified audit report. Australia Ratings suggests this requirement should be applied to at least the two most recent audit reports.

Conditions relating to the bond
Are the proposed conditions set out appropriate?

Australia Ratings believes that initially, reduced disclosure should only apply to vanilla, unsubordinated bonds with no interest deferral. We also question if a lower minimum issue amount than \$50 million may be appropriate especially for smaller companies who may prefer to issue smaller amounts periodically over time. We suggest the minimum should be reduced to \$20 million to encourage more corporates to use the retail corporate bond market.

- Is there a case for adopting any of the alternative conditions?**
In particular:
Should subordination be allowed? If so, is disclosure of the fact of subordination sufficient to protect investors?

It is our opinion that subordinated bonds don't conform to the description "vanilla bond".

Should terms longer than 10 years be permitted? If so, how long should the permitted maximum be, or should there be no maximum?

Australia Ratings believes it will be very difficult for retail investors to assess the creditworthiness of a company for a period beyond ten years. It may be expected that a retail market for vanilla bonds will be more attractive to investors where the original capital is returned to investors for use or reinvestment in a reasonable time period of not greater than ten years.

Should deferral of interest be permitted, or would this be inconsistent with the notion that bonds provide a regular income stream?

Regular payment of interest rather than deferral of interest generally implies a greater capacity of an issuer to service its debt obligations and probably implies a less risky investment for an investor than one where interest and principle repayment is deferred into the future. Regular payment of interest should be an attribute of a "vanilla bond".

If eligibility is extended to bonds that have conditions such as subordination, very long terms or deferral of interest, will far more risk disclosure be required and would this undermine the utility of shorter disclosure for these products?

See comment above.

Is there a risk that investors may confuse more complex products with vanilla bonds, if both types of investment are able to take advantage of simplified disclosure? Is it important that the bonds be correctly described? For example, if an issuer offers subordinated bonds or hybrid-type securities, should it be obligatory that the name of the securities not suggest to retail investors that vanilla bonds are being offered?

It is our view that to increase the confidence of retail investors, the notion of a vanilla unsubordinated Australian dollar bond should not be confused with more complex bonds.

Should the entity or the bond issue be required to have an investment grade rating (if available)? If so, how would an investment grade rating be defined and mandated? What other measures could the Government or ASIC take to enable the provision of credit ratings to retail investors?

The Australian Government has pledged its support to various G20 initiatives and recommendations arising from the 2008 financial crisis. This includes removing reliance on ratings in market regulations. The Financial Stability Board's media release "Financial Stability Board publishes principles to reduce reliance on CRA ratings" of 27 October 2010 asked standard setters and global regulators to adopt its principles for reducing the reliance on credit ratings. Australia Ratings does not believe it appropriate in the context of these G20 initiatives nor fundamentally that a regulatory requirement for an issuer to have a rating of a certain level is good public policy.

It is important to recognise that a difference may exist between the creditworthiness of a company and that of a particular debt security, as expressed in a credit rating. Retail investors are not likely to fully understand the potential differences between and issuer rating and that of a particular debt security.

It is important to note that credit rating agencies do not all have a common definition of "investment grade" (e.g. Standard & Poor's in fact has no definition) so it would be difficult and misleading to include a reference to investment grade in regulations pertaining to retail bonds issued under the proposed short form prospectus. Moreover, it would place ASIC in the position of having to determine what constitutes "investment grade".

Australia Ratings believes the current licensing of credit rating agencies in Australia is appropriate and there are no impediments for credit ratings to be issued and communicated to retail investors provided the appropriate AFSL is held by a rating agency.

Should the prospectus contain prescribed headings and/or prescribed content?

Recommended, but not necessarily prescribed headings may be useful to aid consistency among prospectus for retail debt issues.

Should there be a maximum prospectus length (possibly with ASIC having discretion to increase this)? If so, what should be the maximum length for (a) a standalone prospectus; (b) each part of a two-part prospectus? Could a two-part prospectus be restricted to a maximum total of, say, 40 pages?

Australia Ratings believes retail investors are not well served by unnecessarily long offer documents that obscure important information in lengthy legalistic disclosure. Good policy would be to mandate important information about the terms and conditions of the issue and the credit and investment risks to be clearly and concisely summarised in plain English.

Would it be useful to consumer test one or more examples of 'model' prospectuses?

Yes, this would allow any difficulties with or deficiencies in disclosure to be identified and rectified.

Assuming that headings are appropriate, are the above headings suitable? Would other headings be preferable?

No Comment

Would an investment summary be a useful inclusion?

An investment summary by its nature could only be generic in its form and would not necessarily be able to address the investment objectives or time horizon of investors. That said, provided vanilla bonds exclude subordinated, hybrid or convertible bonds an investment summary may be more straightforward to provide without being so generic to be meaningless.

**Are the content requirements suggested below appropriate?
Are there alternative or additional content requirements that should be adopted?**

See comments below.

Could section 4 be merged with section 3?

No comment.

Is it appropriate to require the inclusion of information on the capacity of the issuer to meet its obligations under the bonds? Would this require the issuer to provide forecasts which should not be required for bond transactions?

A key factor in considering an investment in a bond or debt security is the capacity of the issuer to honour its obligations to pay interest and repay principal in a timely manner. Retail investors should be provided with some guidance of the financial strength of an issuer to meet its obligations under the bond. This may include provision of credit ratings. Reliance just on historical or point in time financial information will be unreliable particularly where the term of the bond is long term e.g. 5-10 years. An issuers business and financial profile will change after issuance and investors will benefit for an ongoing assessment of the issuer's capacity to pay.

If ratios are to be included, should the formulae to calculate the ratios be prescribed and, if so, what formulae should be used?

Australia Ratings believes reliance on a prescribed limited number of financial ratios is problematic. Firstly, they are based on historical information that may be up to 12 months old.

Secondly, there are divergent approaches and definitions of any financial ratios. For instance Australia Ratings includes obligations under operating leases a company may have entered into as debt for the purposes of calculating leverage and interest coverage indicators as they represent fixed claims upon the cash flow of a company before bond holders can be paid. Many may or may not include such commitments in calculating the total debt of an issuer.

Thirdly, it is difficult for a regulator to prescribe ratios that are meaningful and useful to a retail investor across all industry sectors. For example, ratios that may be relevant for a property company are likely to be different for airline or a financial services firm.

Lastly if such ratios are only provided as at a point in time (latest financial report prior to the prospectus date), they will be of limited value in assisting a retail investor form a forward looking view as to capacity to pay over the term of a bond. If ratios are to be mandated an issuer should be required to update and explain them over the life of the vanilla bond (on the issuer's website).

If the abovementioned metrics are not useful given the nature of the issuer or the industry they are in, could the issuer be permitted to use other metrics?

Australia Ratings believes certain ratios are likely to be more indicative of an issuer's capacity to pay and the onus should be on the issuer to disclose any financial metrics most relevant to their business and industry sector.

Would other content requirement reforms, be desirable, for example:
A statement of general principles, including that the complexity of prospectuses is to be minimised, repetition is to be minimised and the focus of disclosure is on matters material to a consideration of an investment in the bonds;
Inclusion of the terms of the bonds and the trust deed (if applicable) on the issuer's website rather than in the prospectus;
Inclusion of a summary of the tax consequences of the bonds for investors rather than a full opinion from a tax advisory firm;
Requiring issuers to refer to other sources of information about themselves such as their Annual Reports and websites; and
Publication by the Government, ASIC and other relevant bodies of relevant general information for investors, including in relation to the calculation and relevance of key ratios. Issuers could be required to refer to this independent information rather than to attempt to provide this advice to investors.

We agree with the proposals set out above. Reference to other sources of information, including credit ratings could be useful for those investors who wish to assess the investment using a variety of information and data sources.

Will retail investors benefit from reading these reports? Also, should account be taken of the fact that not all bonds require a trustee and therefore not all bonds are subject to section 283BF?

It is unlikely that retail investors will read voluminous amounts of information but a well maintained repository of information on an issuer's website may be useful to make available to those investors who may wish to have access at some point to the information.

Do you agree with a two-part prospectus approach, or do you consider it would be preferable to have a prospectus followed by a term sheet and cleansing statement?

Australia Ratings believes a framework similar in concept to that utilised in the United States for SEC registered public debt transactions has merit as a framework for streamlining disclosure in building a diversified and efficient retail corporate bond market.

What is the basis for your view?

An efficient market and one with confident investors could be developed based on an initial lodgement of relevant and concise disclosure by an issuer which is supplemented by necessary information relating to subsequent bond issues under the initial registration statement.

What should be the maximum life of a base prospectus?

Australia Ratings believes a base prospectus with a life of no greater than three years may be appropriate for the issuance of vanilla bonds. It is our view that a company's business, regulatory and market environment changes rapidly today and it would be unusual for a company's circumstances and financial risk profile to remain unchanged for a period greater than 36 months.

Is it feasible and/or appropriate to specify what information should be included in each part of a two-part prospectus, or alternatively in a short prospectus, term sheet and cleansing statement? If so, what should that content be?

A term sheet should set out any information that is specific to the particular subsequent bond issue (use of funds raised, term, interest rate, issue size etc.)

Should there be scope to have information that is 'otherwise referred to', for example the issuer's annual and half-yearly reports, or information such as ASIC's MoneySmart website?

Yes, it would be efficient to reference in the prospectus, but not include, material already publicly available to potential bond investors.

Should it be made clear what the effect of referring to such information will be since it does not form part of the prospectus (for example, could it satisfy prospectus content requirements even though there is no prospectus liability for this information)?

We agree with the proposals to have information that is 'otherwise referred to' and to clarify the effect of referring to such information.

Should directors' deemed civil and/or liability for prospectus content be removed?

No Comment.

Should subsection 708(19) [in relation to ADI's] be amended in the context of these proposed reforms?

Yes, consistency in the offer documents provided to retail investors in bonds issued by corporates or financial institutions would be advantageous in building investor confidence in all retail bond issues.

Is there a need for a transitional period and, if so, what should that period be?

No. We are of the opinion that the revised legislation should be made available for adoption when it is enacted.