

JBWere

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Retail Investor Division
The Treasury
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17 February 2011

Dear Sirs

Submission on the Treasury Discussion Paper "Developing the Retail Corporate Bond Market: Streamlining disclosure and liability requirements"

JBWere Pty Ltd (JBWere) is a pre-eminent financial services organisation that provides a wide range of advisory and wealth management services to a substantial and diversified client base. We seek to be the advisor of choice for our clients throughout Australasia and, through our vast financial networks, provide leading capabilities that extend to financial markets globally.

JBWere has an unparalleled knowledge and experience in the Australasian markets and far-reaching capabilities that extend into global markets. JBWere provides extensive services, across every major asset class, to many private clients throughout Australia and New Zealand.

JBWere manages substantial Fixed Income Assets as part of its total wealth solution. In addition to Managed Funds and Listed Hybrids, JBWere manages roughly \$400m in direct bond holdings for its clients, making it one of Australia's leading Fixed Income advisory houses for high net worth clients.

To that end, we have seen a significant increase in the demand for Fixed Income as part of an asset allocated portfolio. More than ever, clients are acutely aware of the risks inherent in equity-only investing and are seeking guidance and advice on building out the fixed income component of their portfolios.

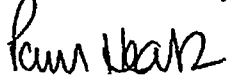
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In our opinion, the development of a healthy retail bond market is integral to assist in de-risking investors' portfolios (particularly superannuation). Australia remains well behind developed capital markets such as the United States and New Zealand in terms of fixed income as a percentage of total assets. We believe this is as much a function of the barriers to entry for investors as Issuers.

JBWere is pleased to provide this submission to Treasury in response to the Treasury Discussion Paper "Developing the Retail Corporate Bond Market: Streamlining disclosure and liability requirements" dated 13 December 2011 (the Discussion Paper). The comments and suggestions provided on how an Australian retail corporate bond market could be developed are largely from the perspective of a retail investor.

Please contact Laurie Conheady, Executive Director, Fixed Income Strategy at JBWere on (03) 9679 1250 or via email on laurie.conheady@jbwere.com should you have any queries on the content of this submission.

Yours Sincerely,



Paul Heath
Chief Executive Officer
JBWere Pty Ltd

Submission

We make the following comments for your consideration (using the questions put forward in the Discussion Paper).

<p>Tailoring/replacement of current prospectus rules</p> <p>Discussion Questions:</p> <p>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?</p> <p>Should the use of a two-part prospectus be permitted?</p>

Comment: No comment.

<p>Proposed entry requirements/eligibility – conditions related to the issuer</p> <p>Discussion questions</p> <p>Are these proposed conditions appropriate? Are there any additional or alternative conditions that should be imposed?</p> <p>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?</p> <p>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?</p> <p>Is the requirement for an unmodified auditor's report appropriate, or is it:</p> <p>(a) inconsistent with audit requirements in other contexts where unmodified reports are not necessary?</p> <p>(b) unnecessary, as some modifications may be positive?</p> <p>(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?</p>

Comment:

We believe limiting the potential issuers to those that are listed is not appropriate as it excludes the bonds of unlisted entities such as government agencies, and privately-owned issuers from being available to retail investors. In many cases these entities offer significant diversity benefits over more mainstream listed entities.

The issue of whether an entity is listed or not and the disclosure requirements should be viewed separately. Adequate disclosure is important and a minimum disclosure requirement should be established for listed or unlisted issuers. If the issuer is listed, its disclosure requirement will likely be met through its compliance with requirements under the Corporations Act. For unlisted issuers, they can report separately. A solution to address the adequate disclosure requirement and the access to this information by retail investors is outlined in comments at page 11 of this submission.

Proposed entry requirements/eligibility – conditions relating to the bond

Discussion questions

Are the proposed conditions set out above appropriate? 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?
- Should terms longer than 10 years be permitted? If so, how long should the permitted maximum be, or should there be no maximum?
- Should deferral of interest be permitted, or would this be inconsistent with the notion that bonds provide a regular income stream?
- 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?

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?

Comment:

We believe that diversity of product type, subject to adequate disclosure of the associated risks and appropriate selling restrictions are the key conditions required. Note, that in many cases the responsibility to ensure the investor is made aware of the unique features of the instrument rests with the adviser. The risk of simplified disclosure may also be mitigated by requiring offers to be adviser driven.

We also believe that consistent terminology and categorisation of offers should be mandated as a part of the disclosure requirements. This can help with risk assessment by potential investors.

The existing listed hybrid market arguably carries higher credit and maturity risk through subordination, deferability of distributions and absence of 'hard' maturities than the more vanilla-type bonds that would be issued in a retail bond market. Where there is the ability to defer interest payments, these instruments should be classified as hybrids as they do not fit the characteristics of a bond. So long as investors and advisers are given the information to evaluate and make informed decisions on those non-vanilla bonds then this is not at odds with the market's development.

The availability of retail bonds and diversity of product are useful in attracting investors. Retail investors differ in their risk appetites, return expectations, and investment horizons. A market that offers investors a variety of risk profiles, yields and composition of returns is one that best meets individual needs. The objective should be the provision of instruments representing a variety of sectors, issuers, instruments (senior secured, senior unsecured, subordinated, fixed rate, floating rate, etc) and maturities.

Use and availability of credit ratings

Discussion questions

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?

Comment:

The current arrangement whereby credit ratings cannot be assigned to fixed income products marketed to retail investors is nonsensical and places the retail investor at a distinct disadvantage versus the generally better resourced and more sophisticated wholesale investor. In an ideal world comprehensive retail-focused research from brokers would fill the void; however, with the current absence of meaningful independent corporate debt research on new and existing issues, credit ratings provide the necessary reference point for retail investors (and their advisers) to assess the credit of the issuer and issue.

Bonds issued need not have investment grade ratings. Although investment grade issues would continue to support the proposition that fixed income is a lower-risk asset class, so long as investors and advisers are given the tools/information to appreciate the distinction between the risks associated with investment grade versus sub-investment grade then they can make a judgement call on the investments.

From a practical perspective, a requirement for a retail bond to be investment grade would raise the following issues:

- o It would be inconsistent with the existing hybrid market where there is no restriction on the requirement for hybrids to be investment grade;
- o It would be at odds with the current restriction on assigning credit ratings to retail products; and
- o It poses the question of what happens to the bond if it is downgraded. Does the product become unavailable to be purchased or sold by retail investors in such a case?

General approach to content requirements and prospectus length

Discussion questions

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

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?

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

Comment:

With respect to documentation, we believe consistency of approach/layout would help investors/advisers in the timely evaluation of the offering.

Content requirements - Prescribed headings/sections and Investment overview
Discussion questions
Assuming that headings are appropriate, are the above headings suitable? Would other headings be preferable?
Would an investment summary be a useful inclusion?

Comment:

The prescribed headings are in line with the existing template for hybrid offer documents. We believe that this layout is clear and easy to follow and highlights the key points for investors.

Detailed contents
Discussion questions
Are the content requirements suggested below appropriate?
Are there alternative or additional content requirements that should be adopted?
Could section 4 be merged with section 3?
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?
If ratios are to be included, should the formulae to calculate the ratios be prescribed and, if so, what formulae should be used?
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?
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.

Comment:

We feel that the more information that can be provided to assess the credit quality of the issuer (i.e. its ability to meet its debt commitments in time and in full) the better it is for the retail investor to make an informed decision.

Other disclosures

Discussion questions

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?

Comment:

Retail investors will vary in the degree to which they involve themselves in the investment decision and ongoing surveillance, and more particularly the degree to which they read appropriate documentation. Nevertheless, in the interest of full disclosure and to enable ongoing assessments to be undertaken (often by advisers and analysts) the information should be made available. Our suggestions as to how the information can be made available in a cost effective and timely manner are outlined at page 11 of this submission.

Using a multi-part prospectus - Division of information between a base and second part prospectus

Discussion Questions

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? What is the basis for your view?

What should be the maximum life of a base prospectus?

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?

Comment:

We believe a minimum level of information should be required in prospectuses to ensure adequate assessments can be made of the offering. Beyond the minimum requirement, market 'push back' in terms of higher yields or lower demand should encourage more detail information to be provided on more complex transactions.

Incorporation of information by reference

Discussion questions

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?

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)?

Comment: No comment.

Liability for prospectus content

Discussion question

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

Comment:

A corporate bond by its nature is akin to a loan to the issuer. This represents a significant point of differentiation to equity investing whereby the investor becomes a part owner in the entity. The requirements with respect to director's liability should be no different between the issuance of a bond (wholesale or retail) and his or her liability with respect to a loan from a bank.

Exemption for prudentially regulated entities

Discussion question

Should subsection 708(19) be amended in the context of these proposed reforms?

Comment:

We submit that this requirement should be removed. Although prudentially regulated, the credit quality of Australian ADIs or entities registered under the Life Insurance Act varies. To ensure investors are kept abreast of any change in the entity's financial position and ability to meet their debt obligations their disclosure requirements should be the same as those of other debt issuers.

Application and transitional arrangements

Discussion question

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

Comment:

We submit that a transition period of six months would suffice. This would allow issuers sufficient time to plan upcoming offers.

Other issues – Investor considerations

We have also identified the following issues that were not directly addressed in the Discussion Paper.

Development of a Sustainable Domestic Retail Corporate Bond Market

There is no single solution for the development of a dynamic, efficient and effective retail corporate bond market. Historical influences (strong equity performance over the past 15 years), lack of knowledge and understanding amongst younger investors in particular, and tax effectiveness of equity investment vis-à-vis fixed income have worked against the take-up of fixed income by retail investors.

The development of a dynamic and fully functioning retail bond market will need a multi-year, multi-pronged strategy to encourage

and incentivise all stakeholders to participate. It would require the 'buy-in' of all stakeholders including government, issuers, investors, ASIC, rating agencies, bond originators, trading houses, advisers, and media.

For a corporate bond market to be sustainable it has to be efficient and effective in matching the demands of issuers for debt capital, with investor demand for low-risk debt products. We believe that the pillars of a sustainable market are:

- product;
- information;
- a trading mechanism (OTC sales and trading or ASX listed); and
- distribution channels to the investor.

We see that the development of the market requires the build out of the product offering and infrastructure required to meet the needs of existing and future market participants. Issuers will require it to be a cost effective and reliable funding source, intermediaries (brokers, advisers, financial planners) need to be encouraged to distribute the product which can only come from a better understanding of the benefits and characteristics of the asset class and the role they play in investment portfolios; and investors need to be educated on the positive influence fixed income can have on their investment portfolio. Ease of access to fixed income assets is paramount and investor expectations with respect to yield will need to be managed.

Benefits to the Investors from an Active Retail Bond Market

For an Australian retail investor, who is typically overweight in Australian equities, the inclusion of government and corporate bonds in their investment portfolios means:

- Better allocation of funds across uncorrelated asset classes;
- Greater diversity of investments, sector, and instruments, with exposures in some circumstances to unlisted companies; and
- Reduced volatility of capital values and cash flows.

From an economic perspective, a functioning retail bond market would provide effective funding for corporations, provide them with diversity of funding sources and reduce Australia's reliance on offshore funding.

Current Impediments

We believe that the development of an active retail corporate bond market is impeded by a number of obstacles. Satisfactory resolution of these impediments will require changes to be made by government, regulatory bodies and the financial services industry. The more salient obstacles are outlined below and addressed in the following paragraphs:

- Wholesale minimum parcel size;
- Tax treatment of fixed income vis-à-vis equity;
- Research and education (of investors and advisers);
- Inconsistent use of credit ratings between wholesale and retail markets;
- Product availability;
- Lack of media coverage; and
- Remuneration of advisers.

Wholesale Minimum Marketable Parcel Size

For many retail investors the current \$500,000 wholesale minimum marketable parcel size required by Austraclear or in accordance with the terms of the bond is a significant impediment to the purchase of corporate bonds. The individual parcels are large which precludes smaller investors. Moreover, in fixed income, the need to diversify holdings to provide protection against downside risk means that a significant level of funds is needed to build out a diversified portfolio when dealing in \$500,000 lots. A relaxation of the minimum parcel size to more manageable levels would enhance the access to product and implementation of fixed income portfolios.

Tax Treatment

In the investment decision, the absence of franking credits for fixed income products places this asset class at a disadvantage compared to equity. The value of franking credits attached to many share dividends and hybrid distributions is a powerful incentive for many retail investors in their investment decisions and ultimately in their asset allocation. The small tax concession on the interest income on fixed income announced in 2010 amounted to a few hundred dollars, was of little value, and provided little incentive to change investor behaviour.

Incentivising investors to participate in fixed income would be assisted at the very least by the establishment of a level playing field between the two asset classes when it comes to taxation. To facilitate a more immediate change in retail investor behaviour thought should be given by the Commonwealth Government to a program of tax breaks to those investors who hold fixed income. This could be a short-term initiative to create demand for/knowledge of the asset class as it would act as a selling point for advisers and value adding advice from financial planners.

Research

The lack of value adding research is an impediment to the development of a retail bond market. By way of contrast, broker reports on equity investments are readily compiled, distributed and available. Corporate debt research is needed to explain the bond offering, but must also be geared to fixed income investment where a focus on credit quality, return for risk, and the liquidity of the issue are the hallmark of the investment decision. With the asymmetrical returns associated with bonds (i.e. on maturity investors can only realise the instrument face value and no more than this), the nuances of fixed income research differs from the more 'blue sky' equity focused research.

Fixed income research would provide a dual role. First and foremost it would form the basis for investment decisions for those investors familiar with the asset class. A corollary of quality research is that it would assist in educating those investors unfamiliar with the instruments.

Education and Media Support

The development of retail investor awareness and understanding will involve the input from a wide range of educational sources. This will include brokers and advisers (as mentioned above), financial planners, education institutions, and the media, from which many investors source their investment updates. In some cases it will involve education of advisers unfamiliar with the asset class.

More specifically the media will need to play a role in making fixed income a mainstream asset class for retail investors. Print, online, and electronic media will need to support the market's development and provide greater coverage through the provision of such things as commentary of fixed income products, the reporting of market developments and at the very least the pricing of available instruments.

Adviser Remuneration

We believe advisers need to be incentivised to promote the asset class such that they are indifferent in offering equity or fixed products. The appropriate reward can be realised through a fee for managing funds under management or through appropriate brokerage on a transactional basis.

Use of Credit Ratings

See comments at page 4 of the submission.

Product Availability - Listed versus Over-the-Counter

We have no preference for a listed retail or over-the-counter bond market so long as there is adequate disclosure of relevant information (see our view on disclosure below), more manageable parcel sizes, and there is appropriate liquidity. Although indifferent between the mode of access to retail bonds, we acknowledge that a listed market, supported by reporting in the media and information sources such as IRESS, would likely provide more transparency of pricing and availability versus an over-the-counter market.

Access to Information

As discussed in the body of the submission, product availability and diversity of product and sector representation is needed to attract investors and represent an attractive investment. A market that offers investors a variety of risk profiles, yields and composition of returns is one that can more appropriately meet individual investor needs.

Access to information on bond issues and the company issuing the bonds is critical for investors to evaluate the bonds prior to issue, and following the issue. We believe that regulators and Treasury should look to the Canadian model where documents relevant to the specific bond offering and the issue are made available on a publicly available website. This is a cost effective and efficient way for investors to access information, and for issuers to ensure they fulfil their continuous disclosure requirements in a very transparent manner.

The Canadian online service is called System for Electronic Document Analysis and Retrieval (SEDAR). It is a mandatory document filing and retrieval system for Canadian public companies (debt and equity issuers) operated by the Canadian Securities Administrators. It can be readily accessed at: sedar.com and covers such documents as prospectuses, financial statements, and material change reports. Arguably with a single securities regulator in Australia, a system like SEDAR should operate more efficiently than the fragmented provincial system in Canada.

We believe the development of an active corporate bond market in Australia and a retail corporate bond market in particular, is needed and would offer significant economic and investment benefits. We are grateful for the opportunity to raise these matters with the Treasury and would be happy to discuss further any of the matters raised in this Submission.