EVANS & PARTNERS

10 February 2012

Manager
Financial Services Unit
Retail Investor Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: RetailCorporateBonds@treasury.gov.au

Dear Sir/Madam

RE: Discussion paper: Development of the retail corporate bond market: streamlining disclosure and liability requirements

Evans and Partners Pty Ltd (EAP) is a full service investment house serving a combination of private, institutional and corporate clients. EAP welcomes the opportunity to comment on the above named discussion paper.

In our view most private investors in Australia are underexposed to fixed income investments. While cash investments and hybrid securities are important investment alternatives, they cannot fulfil the role of vanilla bonds in a portfolio and yet we perceive they are widely used to do so, due to difficulty in gaining access to liquid vanilla bonds in a transparent market place.

We continue to regard the term "retail corporate bond market" as a misnomer. For a market to be successful we believe that it must combine both retail and institutional participants and we have been mindful of this in preparing our response to this discussion paper. A market serving retail investors should also be transparent, which the OTC marketplace is plainly not. Accordingly, EAP continues to advocate the development of a "listed corporate bond market".

The paper which follows this letter itemises individual responses to the questions raised in the discussion paper. Please contact our Head of Debt Markets, Damian Pretty on 03 9631 9801 or dpretty@eandp.com.au if you would like to discuss any of the matters set out in our response in further detail.

Yours sincerely

Damian Pretty
Head of Debt Markets, Partner

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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?

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

We see little reason for an issuer not to utilise the proposed relief, however, we do not believe it should be compulsory to do so. The circumstances in which an issuer may choose not to utilise class order relief are likely to be circumstances in which the directors of the issuer believe that deeper disclosure is warranted than that which is required under the relief. In such circumstances it would seem an appropriate consumer protection to allow issuers not to utilise available relief.

We believe a two part prospectus is of limited value. Our experience in preparing a two part prospectus showed there was excess duplication and no clearer disclosure.

For frequent issuers we would favour an approach that combines a prospectus with a term sheet and cleansing statement.

Are these proposed conditions appropriate? Are there any additional or alternative conditions that should be imposed?

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?

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?

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?**

"the body has continuously quoted securities (for example, ordinary shares) (or is 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)"	In our view 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, should only be eligible where the obligation under the bond is expressly guaranteed by the disclosing entity.
"the bond would be a quoted security if it were quoted"	Agree
"the bond will be quoted on issue"	Agree
"the issuer is entitled to use a transaction-specific prospectus for an offer of its existing quoted securities"	Agree. We note that this provides access to relief for issuers who have unlisted equity but listed debt and see this as a desirable outcome.

"the issuer's continuously quoted securities have not been suspended for more than five days in the previous 12 months"	Agree
"there must be no determination in force disentitling the issuer from using a cleansing statement for a placement or rights issue"	Agree
"on the date of the shorter bonds prospectus, the issuer lodges a copy of the prospectus with the relevant market operator and includes a copy on its website"	Agree
"the auditor's report on the most recent annual financial report, and any subsequent half-yearly financial report, is unmodified"	Agree
ASIC may make a determination not to allow issuance via the shorter prospectus if ASIC is satisfied that the issuer has contravened any of certain specified provisions of Chapters 2L, 2M, 6CA or 6D in the previous 12 months	Agree
We do not believe a minimum issue size should be imposed in order to access the relief.	
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?**	
"the bond is denominated in Australian dollars"	Agree
"the bond is for a fixed term, with the principal payable at maturity or over a defined period of time	Principal should be payable at maturity. In our view amortising bonds are not "vanilla" and risk being

(that is, the principal amortises)"	misunderstood by private investors.
"the interest may be capitalised, or paid periodically during the term of the bond"	We believe that mandatory payment of periodic interest (and principle at maturity) is a critical element of a "vanilla" instrument. For the purpose of this relief we do not believe it is appropriate for interest to be deferrable.
"there must be a fixed or floating rate (that, in the case of a floating rate, comprises a variable market rate plus a fixed margin) — however, this does not prevent the bond from including a feature which increases the fixed margin in certain circumstances provided the potential increase and circumstances in which the increase may occur are disclosed in the prospectus"	Agree, however, we have some reservations that the ability to increase margin in defined events could be misused. For example, a vanilla bond should not have step up and call features that may imply a commercial maturity at an earlier date than the legal maturity.
"if the bond may be redeemed before the expiry of the fixed term, it may only be redeemed in one or more specified circumstances (whether or not the redemption would be subject to conditions)"	We agree with the conditions proposed in footnote 3 of the discussion paper.
"the bond may be either unsubordinated or subordinated"	We believe that vanilla bonds should rank equally with unsecured creditors.
"where the bond is issued by a wholly-owned financing subsidiary, the bond must be guaranteed by the listed parent company or a group member (or be supported by similar group financing arrangements that are disclosed); *– noting that, if the guarantor is a group member and it would not be appropriate to use the financial accounts of the listed parent company to represent the financial position of the group member in the prospectus, then the issuer should be required to seek ASIC guidance/relief in relation to the use of appropriate financial accounts and of a short bonds prospectus"*	In our view an explicit guarantee from the listed parent company may be acceptable. We do not agree with an approach that allows utilisation of the proposed relief on the basis of a guarantee from another group member which is not the listed parent company.
"the bond is not convertible into any other security"	Agree
"the bond is issued to all investors at the same price under the shorter bond prospectus — however, this does not prevent fees being paid to underwriters, sub-underwriters or cornerstone investors in the bond"	Agree. We believe it is important for the market that transactions can be derisked by cornerstone investor commitments made prior to launch.

"the issuer is not to offer any debentures for issue to a holder of the bonds under the exemption in subsection 708(14)"	Agree

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?

In our view subordination is not consistent with the concept of a vanilla bond and should not be allowed. We reiterate that vanilla bonds should rank equally with unsecured creditors. We acknowledge this gives rise to the possibility of subordination by virtue of other lenders holding security over assets of an issuer.

We believe that increasing the duration of fixed income securities may offer substantial portfolio benefits to private investors and long term stable funding to issuers with long duration assets. Accordingly, we believe that 20 years may be a more appropriate maximum term. We note that Australian investors have long been averse to buying long dated fixed income securities and that this reticence would likely limit issuance of long dated paper under the relief in any case.

Deferral of interest should not be permitted. We believe that deferral is inconsistent with the term "vanilla bond" and that allowing this flexibility may see the relief widely used to issue hybrid style securities rather than vanilla bonds.

The further the conditions of the relief deviate from the concept of a vanilla bond the greater the risk disclosure required and the higher the likelihood that the intent of the relief would be undermined. We believe that the two most simple characteristics that define a "vanilla bond" are:

1. regular mandatory interest payments (with non-payment constituting an event of default and giving rise to a holders right to accelerate repayment); and
2. simple bullet maturities.

It is inevitable that holders will confuse hybrids and vanilla bonds if both types of security are able to utilise the same "vanilla bonds" relief. We believe that it should be obligatory for instruments which are explicitly subordinated to be named in a way that directly conveys that subordination. Similarly, if an instrument is "unsecured" we believe it would be helpful for that term to be used to describe a bond.

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?

We believe that credit ratings are a useful tool for both retail and institutional investors and we encourage issuers to seek ratings on interest rate securities sold to retail investors. However, we do not believe that ratings should be mandatory as it may not always be practical to have a transaction rated.

If the Government and ASIC form the view that requiring bonds to have ratings is appropriate, then we would suggest that no threshold of rating should apply. We think that the success of the market will partly by determined by the extent to which a credit curve can be established to assist pricing of a range of transactions.

The offer of Australian Unity Notes was rated by Australia Ratings. Our experience through this transaction demonstrated the value of a rating in engaging both institutional and private investors (and their advisers). One particular improvement in the provision of ratings information to investors under the offer of Australian Unity Notes was the provision of a Product Complexity Indicator (PCI) which is a measure moving beyond the issuers credit quality and dealing with the structure of a particular security.

"*A PCI is a colour coded indicator to help differentiate debt securities which may have similar credit attributes but may help highlight complexity in the terms and conditions of the security that could rise to unanticipated variability or change in the returns from the investment*".

Given the recent (and anticipated) prevalence of hybrid transactions structured to achieve equity credit with the traditional ratings agencies, we believe that the Government or ASIC could assist the adoption of ratings by providing an explicit relief to allow the reference to senior ratings from (unlicensed) traditional agencies in the terms of issue of a transaction on the proviso that the security being issued was itself explicitly rated by a credit rating agency licence to provide ratings to retail investors. We believe that such a move may see increased adoption of the use of retail credit ratings by major issuers.

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?

The prospectus should contain prescribed headings and content. This would given greater clarity and certainty to issuers and investors regarding ASIC's expectations of disclosure.

There should NOT be a maximum prospectus length. To the extent that an issuer determines a level of disclosure is required in the interest of investors it would seem odd for the regulator to deny them a higher level of disclosure. We do not believe it would be practical for issuers to rely on ASIC discretion to extend a page limit as this may involve issuers having to frequently engage ASIC prior to commencing transactions.

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

Would an investment summary be a useful inclusion?

EAP has considered the applicability of the proposed headings in drafting a mock prospectus. Having worked through the practical exercise we believe that the Sections set out in the RHS below may be appropriate. These are small changes to the sections proposed in the discussion paper based on simple considerations such as benefits to investors already being explicit in the overview of the instrument.

Discussion Paper Proposed Sections: 1 — Timetable 2 — About *[name of issuer of retail corporate bond]* 3 — How *[name of retail corporate bond]* works 4 — Benefits of investing in *[name of retail corporate bond]* 5 — Risks of retail corporate bonds 6 — Summary of the financial position of the issuer of the retail corporate bond 7 — Summary of how the retail corporate bonds are taxed 8 — Summary of the interests of advisers and of any fees relating to the retail corporate bond 9 — Summary of how to apply for the retail corporate bond 10 — Other information	**EAP Suggestion:** 1 — Timetable 2 — Overview of *[Issuer]* 3 — Overview of [*Instrument name*] 4 — Financial Position of [*Issuer*] 5 — Key Risks of [*Instrument name*] 6 — Australian Tax Implications 7 — Interests of Experts [*Summary of the interests of advisers and of any fees relating to the retail corporate bond*] 8 — Other Information [*additional information deemed relevant disclosure by the issuer*] 9 — Terms of [*Instrument name*] 10 — How to Apply 11— Glossary

We believe that the investment summary can be captured succinctly as part of the Overview of [instrument name] unless a separate overview is limited to one page.

Drawing on the suggestions in the discussion paper we have set out below our views re content requirements:

EAP Suggestion:

1 — Timetable
This section could include a timetable setting out the key dates in relation to the offer.

2 — Overview of *[Issuer]*
This section is intended to provide an overview of the issuer and its business, the amount the entity intends to raise and the purposes to which the money will be put. If applicable this section can also include information from a credit ratings agency.

3 — Overview of [*Instrument name*]
Having established an understanding of the issuer, the investor should then focus on understanding the type of instrument being offered and its key terms. In this regard we believe the entire list of information proposed to be included in the discussion paper be incorporated. We believe this section can also include, if applicable, information on a Product Complexity Indicator from a licensed ratings agency.

We believe that the benefits of investing in the instrument should be self evident in this section and should not be given additional emphasis elsewhere.

4 — Financial Position of [*Issuer*]
Understanding the nature of the issuer's business and the instrument offered under the prospectus it is appropriate next for investors to understand the financial context in which the offer is made. Again, we are happy with the proposed content requirements set out in the discussion paper for section 6 (our section 4).

5 — Key Risks of [*Instrument name*]
We are comfortable with the risks proposed as section 5 in the discussion paper.

6 — Australian Tax Implications

We agree that this section should summarise the significant tax consequences of investing in the bonds.

7 — Interests of Experts [*Summary of the interests of advisers and of any fees relating to the retail corporate bond*]
We are comfortable for this section to be based upon content requirements of the proposed section 8 in the discussion paper.

8 — Other Information [*additional information deemed relevant disclosure by the issuer*]
We are comfortable for this section to reflect content requirements of the proposed section 10 in the discussion paper.

9 — Terms of [*Instrument name*]
We believe that the terms of issue must be detailed in the prospectus. More than any other part of the document the terms will be continuously referred to by investors long after the offer is complete.

10 — How to Apply
We are comfortable for this section to reflect content requirements of the proposed section 9 in the discussion paper.

11— Glossary
Every prospectus requires a glossary to assist investors understand and interpret the contents of the document.

Could section 4 be merged with section 3?

As stated above we do not believe that the benefits of investing should be given additional emphasis. They should be self evident in the overview of the instrument.

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?

We believe that it is appropriate to require the inclusion of relevant financial ratios to assist investors as they assess the ability of the issuer to meet its obligations under the bonds. This approach should not necessitate the use of forecasts.

An issuer should have flexibility in regards to the formulae used to calculate certain ratios as prescriptive ratios may have limitations to their relevance for given issuers. By way of example, we point to the prospectus for the offer of “Peet Notes”. Although Peet Notes are a convertible security, in drafting the prospectus regard was still given to the requirements of ASIC Class order [10/321]. The prospectus (in section 4.2) included “gearing ratios” based on the methodology used to calculate gearing for its other lenders, which was considered to be the most meaningful formula for investors in Peet Notes to assess the capacity of the issuer to meet its obligations under the Peet Notes.

To the extent that ratios are prescribed we believe it may be useful to consider a Leverage Ratio (i.e. Net Debt: EBITDA) in addition to those ratios described in ASIC Class order [10/321]. While a gearing ratio may be more useful to investors assessing an issuer whose business relies on its tangible assets, the leverage ratio

is more likely to be of use to investors assessing an issuer who operates, for example, in a services industry, where cash flow is more critical than hard assets.

Issuers should at all times be permitted to include additional ratios where they are considered to be relevant to investors. In our view constraining the number of ratios that may be used would reduce the quality of disclosure. For example, an issuer such as a retailer who has leased the majority of their stores may believe that a Fixed Charges Cover Ratio, capturing rental obligations, provides information more critical than any of the more common ratios (those in ASIC Class Order [10/321] and the Leverage Ratio).

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 believe a clear and concise statement of general principles would be desirable.

In our view the terms of issue must be included in a prospectus and should not be incorporated through reference to a website. Although summaries may be useful it is critical that investors do see the full terms on which their investment is made.

We are comfortable that a trust deed can be included on an issuer's website rather than in the prospectus as long as material factors under the trust deed impacting on investors are considered in the prospectus.

We are happy for a summary of tax consequences to be included rather than a full opinion.

Issuer's should be required to refer to their annual reports and/or half yearly accounts.

Relevant publications from Government, ASIC and ASX, should be considered by issuers. To the extent applicable documents are available, such as the ASIC Guide "Investing in corporate bonds?" reference could be compulsory.

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?

In our view retail investors will not benefit from disclosure under 283BF. However, investors will benefit from half yearly and annual updates of key financial ratios.

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?

We do not agree with a two part prospectus approach. The information that needs to be updated is sufficient that a two part prospectus as proposed under ASIC Class Order [10/321] offers little potential benefit compared with updating and reissuing a simple short form prospectus. Our experience in the offer of Primary Bonds Series A affirms this view. We also believe that given the split of information across the two parts this approach leads to more confusion amongst investors rather than less.

We believe a prospectus followed by term sheet and cleansing statement is likely to be a more successful approach. This could be coupled with a requirement to state the impact on relevant financial ratios likely for each transaction contemplated by term sheet. Such a prospectus could have a life of up to 5 years.

As stated above we do not agree with a two part prospectus approach. However, we believe a term sheet approach is appropriate. Such a term sheet could include issue and maturity dates, interest payment dates, interest rates, credit rating (if applicable) and be supplemented by updated pro-forma financial ratios.

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)?

There should be scope to allow information referencing where appropriate. It should be clear that such information does not form part of the prospectus.

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

No comment.

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

No. We are keen to see the exemption continue for both listed and unlisted ADIs.

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

No.