22 February 2012

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

Development of the Retail Corporate Bond Market: Streamlining Disclosure and Liability Requirements

This submission by the Corporations Committee of the Business Law Section of the Law Council of Australia ('the Committee') is made in response to the Discussion Paper issued in December 2011 titled *Development of the retail corporate bond market: streamlining disclosure and liability requirements* ('the Discussion Paper')..

The Committee recognises the benefit in further consideration being given to the appropriate manner in which to encourage the development of a corporate bond market in Australia which can be effectively accessed by retail investors. The Committee agrees with the points made in paragraphs 16 and 17 of the Discussion Paper, that there are structural issues that may continue to prohibit the development of a strong Australian corporate bond market, however, the Committee acknowledges that many of the proposals in the Discussion Paper, particularly those that encourage better quality disclosure to retail investors, and which remove some of the burden of compliance from issuers, are an appropriate part of a coordinated response to the development of the Australian corporate bond market.

Responses

Tailoring/replacement of current prospectus rules

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 use of a short form/ simplified prospectus for bond issues prepared in accordance with the outcome of the Discussion Paper ('Simplified Prospectus') should not be compulsory. The existing prospectus offer mechanisms under the Corporations Act should remain available to issuers if they chose to use them. This is the same situation which arises currently as appropriate issuers are able to decide whether to use a section 713 prospectus or a 708AA cleansing statement for a rights issue.

If the use of Simplified Prospectuses is accepted by issuers and investors, the Committee expects that the majority of offers of eligible bonds would ultimately be made under the Simplified Prospectus structure.

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

The Committee agrees that a two part Simplified Prospectus option should be available in conjunction with a single part Simplified Prospectus option.

Not all issuers of eligible bonds will want or need to set up a two part prospectus structure as they may be issuing bonds only as a one off capital raising or may seek to have different series of bonds with different terms on issue. For those issuers, access to a single part Simplified Prospectus option will be sufficient.

For those issuers who want to be in a position to raise capital through potentially multiple issues of eligible bonds differing in only limited aspects, such as term, interest rate and interest payment dates, the use of a base prospectus and an issue specific document which together include all the disclosure required under a Simplified Prospectus is appropriate.

The issue specific part of a two part Simplified Prospectus should be kept as simple and as short as possible and consideration should be given to this document effectively being a term sheet identifying the issue specific terms, which advises investors to read the base prospectus and the most recent half year or full year accounts and to take account of subsequent continuous disclosure releases and includes issue specific financial information. Any "excluded information" as that term is used in section 708AA of the Corporations Act should also be disclosed. Only the issue specific part of the prospectus would be issued for each series of the bond with the base prospectus available to be viewed on-line or at the request of an investor.

As discussed in the context of the potential changes to directors liability below, consideration could also be given to whether the appropriate liability regime for a Simplified Prospectus is the general Corporations Act liability regime that applies to a rights issue undertaken using a cleansing notice under section 708AA.

Proposed entry requirements / eligibility – conditions related to the issuer

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

Yes. The Committee generally agrees with the proposed conditions.

In particular, the Committee supports the reliance on continuous disclosure rationale for the simplified disclosure regime referred to in paragraph 23 of the Discussion Paper.

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?

Having regard to the rationale referred to in paragraph 23 of the Discussion Paper, the Simplified Prospectus disclosure regime should only be available to entities (or their guaranteed wholly owned subsidiaries) who are subject to the continuous disclosure and

periodic disclosure regime under the ASX Listing Rules and the Corporations Act. This could include unlisted entities which have existing listed securities eg debt securities on issue which cause them to be subject to the continuous disclosure rules.

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?

Yes, provided that there is an appropriate guarantee by the listed parent entity who itself would be eligible to use the Simplified Prospectus disclosure regime.

This structure reflects a usual financing structure for listed groups which contain a group financing subsidiary.

There would be a need for appropriate disclosure of the guarantee and its position within the capital structure. In the case of a two part prospectus, this disclosure would be in the base prospectus.

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?**

While an unmodified auditor's report is not required for an issue of a bond under a section 710 prospectus or for an issue of equity through a rights issue under either a section 713 prospectus or using a cleansing statement, the Committee considers that in the context of creating a simplified prospectus disclosure regime to encourage the development of a bond market the existence of an unmodified report is appropriate and may assist in providing a level of quality control in relation to issuers able to use the simplified disclosure.

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?

Further consideration needs to be given to the types of bond that would qualify to be offered under the Simplified Prospectus regime and what type of bond market is being encouraged. Bonds that are more complex than ASIC's designated 'vanilla bonds' have been issued under the existing regime including recently by Woolworths, Origin, Tabcorp and Colonial.

Subordination, long terms and deferral of interest mechanisms could be features of eligible bonds, however it would be important that significant disclosure, with appropriate emphasis, was included to clearly explain these features. These features are available to an issuer that is prepared to issue a prospectus which complies with the current law and as a matter of principle should be available to an issuer provided that the features are properly disclosed.

Subordination and its consequences are generally a concept that is more likely to be able to be clearly explained to investors than the potential for interest deferral. At least some structural subordination is likely to be an issue for many potential issuers of bonds and as such issuers should be required to disclose legal or structural subordination and its consequences clearly.

One option that could be considered for more complex bonds is that they be able to be issued under a section 713 prospectus, such as is the case for convertible bonds, while the more simplified prospectus regime be available to more simple bonds.

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

The Committee considers that as long as there is clear disclosure of the term, then a term of more than 10 years is acceptable. However, the term should not be perpetual on the basis that retail investors should have a right to repayment at the end of a stated term.

Consideration should be given to guidance on more specific disclosure for long term bonds and the associated consequences eg in the case of fixed interest bonds with a long term their rate will not move in line with the prevailing market. While that could be both a benefit and a risk of a long term fixed rate bond, it should be clearly disclosed.

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

As noted above, deferral of interest can add a significant level of complexity to bonds, and will require appropriate disclosure. If this feature was available for bonds to be issued under a simplified disclosure regime, that regime would need to accommodate detailed disclosure of the deferral mechanism and its consequences.

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?

Clear disclosure would be needed of the risks of these aspects of a bond. Provided appropriate emphasis, and explanation of consequences, was placed on these features in the disclosure, simplified disclosure may still be appropriate. Alternatively, the section 713 style prospectus could be required.

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?

As a matter of clear disclosure, the Committee suggests that any naming of bonds would need to be just a description which is simple and accurate “floating rate subordinated note” or “fixed rate unsubordinated note”. It is unlikely to assist clear disclosure to require the term of bonds to be specified in the name, unless the term is fixed with very limited redemption rights, or to require reference to deferral rights.

Use and availability of credit ratings

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?

It may well be beneficial to require some objective assessment of "quality" of an issuer before it can use the simplified disclosure regime. However, the major credit rating agencies do not have a retail Australian Financial Services Licence which would allow the inclusion of their credit ratings in a retail disclosure document, and it would seem in some respects at odds with that position to impose credit rating criteria to determine whether an issuer could use the simplified disclosure regime.

It may also be an undue burden and cost on smaller issuers to need to obtain a rating for their bonds before they are able to use the Simplified Prospectus regime. Particularly as such issuers may be unlikely to need a credit rating for any other reason. However, it is an issue that deserves further consideration as the requirement to have a rating may be a relevant threshold to whether an entity should be able to use the simplified disclosure regime.

The use of a rating does have the potential to provide an independent assessment of the bond and its issuer that may be of use to retail investors, however, it should not be a substitute for ensuring that the issuer otherwise meets its disclosure obligations.

What other measures could the Government or ASIC take to enable the provision of credit ratings to retail investors?

The Committee considers that this is a policy issue which requires further discussion between ASIC, Treasury and the relevant ratings agencies to determine whether a situation can be reached were ratings agencies are willing, and able, to provide a rating that can be used by retail investors.

However, in the absence of that arrangement, the Committee considers that a simplified prospectus disclosure regime should be progressed.

General approach to content requirements and prospectus length

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

As a general position the Committee does not consider that the strictly prescribed headings or content are appropriate for prospectuses given the general disclosure tests in the Corporations Act. However, in the context of the simplified disclosure proposal the Committee agrees that heading and content guidelines should be developed to assist in preparing shorter and more useful documents for investors and to assist them in being able to assess and compare alternative investments. This approach and appropriate consultation with the industry may lead to a relatively standardised disclosure document being used by issuers keen to easily raise funds through the retail bond market.

An appropriate Regulatory Guide issued by ASIC in consultation with Treasury and the industry would be appropriate.

Issuers would however, need to bear in mind that they retain an obligation to ensure their disclosure is relevant for them and their offer and that they are not able to simply tick the boxes on disclosure. It would be helpful if any ASIC guidance states clearly that any headings suggested are not mandatory.

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?

No. The focus should be on ensuring appropriate disclosure, including through guidelines for headings and content. A focus on page numbers is artificial and unhelpful.

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

Yes. As part of the consultation process in preparing a Regulatory Guide appropriate model templates could be usefully developed.

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

The Committee generally agrees with the headings and also the content discussed below.

However, in the context of a two part prospectus the Committee does not consider that the base prospectus needs a timetable as that would be in the issue specific document. Consideration would also need to given to the inclusion of financial disclosure in the base prospectus as publicly available full and half year accounts could be referred to. Transaction specific financial information such as the increase in net debt or the overall effect on the balance sheet, and potentially ratios, may be included in the issue specific document.

Would an investment summary be a useful inclusion?

The Committee considers that an investment overview / investment summary section consistent with the approach contained in Regulatory Guide 228 is appropriate provided that it does not lead to undue repetition in the prospectus.

Detailed contents

Are the content requirements suggested below appropriate?

The Committee generally agrees with the content requirements. This is particularly the case where a single part prospectus is used.

Where it is intended to use a base prospectus and a subsequent issue specific document, the Committee considers that the issue specific information should only be included in the latter to ensure that it remains short and simple. This would include the timetable, pricing and offer size, specific bond terms and relevant specific financial information.

There should not be a restriction on issuers including additional information if they consider that it is necessary to enable them to meet their disclosure obligations.

Are there alternative or additional content requirements that should be adopted?

The Committee is satisfied with the suggested content.

Could section 4 be merged with section 3?

On the basis that the simplified disclosure document should be as short as possible, to the extent that section 3 and 4 would repeat information, the sections should be merged.

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?

The Committee does not consider that the issuer should be required to include forecasts, however, consideration should be given to including disclosure based on the most recent historical financial information, for example appropriate ratios with an explanation of the basis of calculation of those ratios to demonstrate the issuer's debt servicing capacity based on the most recent half year or full year accounts.

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

The Committee considers that consideration should be given to the use of appropriately calculated basic ratios. The Committee appreciates that different businesses and different industries consider that certain ratios or calculation methodologies are not appropriate for them, however, as with accounting standards, standard ratios may be able to be required to be disclosed and then the issuer would be entitled to explain why a different ratio or calculation methodology is more appropriate for their particular circumstances and include that ratio.

The Committee acknowledges that the inclusion of similar but different ratios may require additional explanation, however, it is potentially a way to achieve a level of consistency across issuers.

An alternative may be to require that categories of ratios be included eg a leverage ratio, and require the issuer to clearly explain the calculation of the ratio and why it is the appropriate ratio for that issuer.

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?

As noted above, if basic ratios or categories of ratios are prescribed, that should not prevent issuers using other metrics and explaining their reasoning for their use.

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;

The Committee considers that a statement of policy from ASIC along these lines would be appropriate. However, we do not consider that it should be written into legislation.

Inclusion of the terms of the bonds and the trust deed (if applicable) on the issuer's website rather than in the prospectus;

The terms of the bonds should be included in the single part prospectus or the base prospectus. The terms should also be available on the issuer's website and for delivery to investors who contact the issuer seeking a hard copy of them.

The Committee does not consider that the trust deed needs to be included in the single part prospectus or the base prospectus or incorporated by reference, although we consider that a summary of the trust deed should be included in the single part prospectus or base prospectus or incorporated by reference.

A copy of the trust deed should also be available on the issuer's website and for delivery to investors who contact the issuer seeking a hard copy of it.

Inclusion of a summary of the tax consequences of the bonds for investors rather than a full opinion from a tax advisory firm;

The Committee considers that this approach is appropriate provided that investors are given appropriate disclosure of the tax consequences.

Requiring issuers to refer to other sources of information about themselves such as their Annual Reports and websites;

The Committee agrees with this. Such information should not need to be incorporated by reference and become part of the prospectus, however, it remains useful information for investors to have access to and underpins, along with other continuous disclosure materials, the basis for the simplified disclosure.

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.

The Committee agrees with this approach, provided that there is an acceptance between the publishers of the information and the industry that the general information is appropriate. Publications of this kind should be prepared in consultation with industry participants.

Issuers should not need to seek the consent of the publishers to refer to the information and should not be liable for its content.

Other disclosures

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?

The Committee does not consider that this information is likely to be particularly useful to retail investors.

Using a multi-part prospectus

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?

As noted above, the Committee agrees with the use of a two part prospectus for issuers that propose to have a series of issues of their bonds, in which case the issue specific document should be limited to issue specific information such as the timetable, issue size, the interest rate, interest payment dates and use of funds and relevant financial information. Series issues would be done by issuing only the specific issue document which refers to the base prospectus being available.

This structure provides appropriate general disclosure upfront, then relies on compliance with continuous disclosure to provide for subsequent issues under a short specific document. This structure would streamline disclosure significantly for issuers while providing investors with a similar type of disclosure arrangement as for rights issues. If the second part document is required to be too long, it is likely to defeat the benefit to issuers of being able to offer under a two part offer document.

In the same way as for a section 708AA rights issue, the issue specific document should include any excluded information.

In the context of a single offer the Committee considers that a one part Simplified Prospectus is appropriate and is most likely to provide investors with the appropriate information. The Committee expects that this would be the most common form of simplified disclosure as there will be a relatively limited number of issuers who would seek to have multiple series of bonds, although some may seek to keep that option available to them.

\What should be the maximum life of a base prospectus?

The Committee considers that two years remains an appropriate period. However, consideration should be given to the ability for an issuer to update their base prospectus in between offers so that the issuer is able to still issue just an issue specific document for each issue referring to the base prospectus. This updated base prospectus should potentially replace the previous one as opposed to supplement it, so that investors have access to a single base prospectus in addition to the issue specific document.

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?

The Committee considers that a general statement of the information to be included in each part is appropriate with the intention being that the issue specific document be short and largely constrained to:

- specific information about the bond being issued;
- advice that investors have regard to the base prospectus containing the bond terms and more general information;

- the timetable and information necessary to apply;
- any excluded information to update the continuous disclosure of the issuer; and
- issue specific financial information such as ratios and the impact of the funds raised on the financial position of the issuer.

Incorporation of information by reference

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, as noted above. Such information should not need to be incorporated by reference and become part of the prospectus, however, it remains useful information for investors to have access to and, in the case of issuer information, underpins, along with other continuous disclosure materials the basis for simplified disclosure.

The third party information referred to may also be useful, but should not be the responsibility of the issuer.

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)?

The issuer's information referred to should not need to form part of the prospectus. This information is usual periodic or continuous disclosure information, with its own disclosure and liability framework.

Liability for prospectus content

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

The Committee considers that a more general debate should be had in relation to deemed civil liability of directors, rather than in isolation in relation to the issue of bonds. In particular, any liability on directors where the onus of proof is reversed (as it currently is under the prospectus civil liability regime) is not appropriate.

Such a debate also needs to consider clarifying that directors may delegate responsibility to others and that this would be a basis for any due diligence defence.

While deemed liability for the issuer and others involved in the process remains, a due diligence process will still need to be undertaken and therefore the removal of deemed liability for directors personally will not necessarily streamline the necessary investigations undertaken to prepare the prospectus.

Further any desire to streamline the process undertaken by an issuer needs to be carefully counterbalanced against the necessity of investors being provided with appropriate reliable information to make their investment decision.

An alternative for liability in relation to a Simplified Prospectus would be to remove the issue from the prospectus liability provisions and leave the liability for such offers to the

general provisions of the Corporations Act the same as for a rights issue undertaken without a prospectus or product disclosure statement.

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

No. ADIs remain one of the most likely sources of high quality retail focussed bonds.

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

No, provided that appropriate notice is provided to the market of the introduction of the proposals and they remain optional for issuers to adopt.

Further contact

Should further discussion of the foregoing be necessary, please contact Mr Tim McEwan at Freehills either by phone on 03-9288 1549 or via email: tim.mcewan@freehills.com

Yours faithfully,

Margery Nicoll
Acting Secretary-General