MALLESONS STEPHEN JAQUES

Australian Government Discussion Paper December 2011: *Development of the retail corporate bond market: streamlining disclosure and liability requirements*

Submission by Mallesons Stephen Jaques

INTRODUCTION

This submission is made in response to the Australian Government's December 2011 discussion paper entitled "*Development of the retail corporate bond market: streamlining disclosure and liability requirements*" ("**Discussion Paper**").

We are in favour of the proposals in the Discussion Paper, as measures intended to encourage the further development of the corporate bond market in Australia. In particular, we agree that the process for the raising of debt capital in the Australian corporate retail bond market can be streamlined without jeopardising consumer protection.

If the proposals set out in the Discussion Paper are accepted, it will be of broad benefit to issuers, investors, intermediaries and the Australian and regional debt capital markets more generally. In particular, it will enhance Australia's position as an important financial hub for the Asia-Pacific region. Whilst there are other market issues that will impact upon the development of the Australian corporate retail bond market, we do regard the proposed initiatives as significant steps towards that goal.

However, we are also of the view that there are certain elements of the proposals that could be enhanced to encourage higher levels of use by issuers, in contrast to ASIC's 'vanilla bonds' class order relief [CO 10/321]. Despite some important changes, the low usage of that class order relief suggests that the additional advances suggested by the Discussion Paper will be necessary and important steps forward.

Accordingly, this submission responds to the matters raised in the Discussion Paper and also suggests some possible modifications. These modifications are suggested in order to give the proposed reform every opportunity to be fully utilised by issuers and to act as a genuine stimulus to the development of a deep and liquid corporate retail bond market for both Australia and the broader Asia-Pacific region.

We would welcome any opportunity to discuss any of the matters raised in this submission and the form of amendments prior to those amendments being finalised by Treasury.

For further information please contact:

Shannon Finch | **Partner** **Mallesons Stephen Jaques** Level 61, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000 T +61 2 9296 2497 | M +61 400 442 991 | F +61 2 9296 3999 shannon.finch@mallesons.com | Partner profile | www.mallesons.com	**Philip Harvey** | **Partner** **Mallesons Stephen Jaques** Level 61, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000 T +61 2 9296 2484 | M +61 439 190 394 | F +61 2 9296 3999 philip.harvey@mallesons.com | Partner profile | www.mallesons.com

RESPONSES

TAILORING / REPLACEMENT OF PROSPECTUS RULES

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

No. The choice of the appropriate form of disclosure in all the circumstances should be a matter for the judgment of each issuer, and a mandatory rule will produce some results that are inappropriate.

However, we are confident that eligible issuers issuing eligible bonds will tend to utilise a streamlined prospectus regime where the process offers improved efficiency (both in time and cost) and a rational liability regime.

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

We strongly endorse the use of a modified 'two-part prospectus' approach or 'modified shelf' approach, as one of the available options. For instance, that could be a model that is not dissimilar to that used in Europe under the EU Prospectus Directive.

Alternatively (or as a further option) – an initial prospectus could simply be used in conjunction with later 'cleansing notices', to provide a close parallel with processes for equity issuance and to take advantage of Australia's continuous disclosure regime, without the cost and process involved in maintaining a Base Prospectus. We strongly endorse this second alternative.

In the Australian context, this would be as follows:

- **Base prospectus**: eligible issuers would prepare a "**Base Prospectus**" that includes the prescribed content described below, laid out under specific headings. This would appear in a mandated order and form of presentation for consistency across all issuers. This would allow ease of comparison by investors across issuers and eligible bonds. This Base Prospectus would also set out the base terms and conditions on which all series of eligible bonds would be issued subject only to completion of the pricing information relevant to a particular series of eligible bonds.

- **Continuous disclosure**: the eligible issuer would be subject to continuous disclosure obligations and required to file any information that could reasonably be expected to have a material impact on the price or value of its eligible bonds, under Listing Rule 3.1 (e.g., half-yearly reports, material changes in business).

- **Updating the 'shelf' prospectus:** the Base Prospectus would be valid and have a "shelf-life" of up to 2 years. It could be updated either by continuous disclosure or by a supplementary or replacement prospectus ("**Supplementary Prospectus**") at any time during its two year life span. A Supplementary Prospectus could be filed at any time during that period if the relevant issuer becomes aware of any material new factor or omission from the Base Prospectus that is better communicated by an update to the Base Prospectus, rather than pursuant to its ordinary continuous disclosure obligations (eg a change to the base terms and conditions).

- **Pricing supplement (to the shelf):** at the time of launch of any issue of eligible bonds, the issuer could file a "Pricing Supplement" that includes the relevant pricing information for that series of eligible bonds. The Pricing Supplement would include only practical administrative,

operational and pricing information (such as term, interest rates, opening and closing dates for the offer). It would form part of the prospectus, and be subject to the prospectus liability regime.

- **Cleansing notice alternative:** as an alternative to the modified shelf approach, once an initial Base Prospectus has been issued, subsequent vanilla retail debt issuance could simply be accompanied by a cleansing notice similar to that used for a rights issue or institutional placement. The cleansing notice would provide a mechanism for disclosing pricing information and tenor, any necessary updated information, and information material to the price or value of the bonds that has not already been disclosed under continuous disclosure. The Cleansing Notice would not be subject to the prospectus liability regime – it would be regulated in the same way as Cleansing Notices for equity issuance.

There are significant advantages of the ‘modified shelf’ comprised of a Base Prospectus which is updated through continuous disclosure and/or a Supplementary Prospectus throughout its lifespan, used with a Pricing Supplement for each issue:

- It should facilitate the necessary short and medium-term cost benefits many larger issuers to consider establishing a standing “programme” for the issuance of retail debt;

- it has a useful resonance with off-shore processes in the European markets, and is not dissimilar to some registered US processes (although these are not often taken up by Australian issuers).

However, the investment in maintaining and updating a Base Prospectus will not appeal to all issuers. We are strongly supportive of an alternative (or additional) proposal that permits a streamlined Base Prospectus to be used in conjunction with simple cleansing notices. This would also offer significant advantages to both large and small issuers and:

- it is familiar to the retail market;

- it does not incur interim costs, and the process costs of issuing a cleansing notice tend to be lower than a prospectus process, because of the different liability regime;

- it is flexible to permit tap issues but does not commit issuers to a “programme”; and

- the liability regime for the cleansing notice does not involve prospectus liability, and has become familiar to boards through the use of rights issue cleansing notices and can improve availability of underwriting support.

At the same time, the applicable liability regime for cleansing notices offers appropriate investor protection.

Each of these proposals would represent a significant change to the current disclosure rules. However, we believe that a significant change is both warranted and needed to provide support for the development of a retail bond market in Australia.

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 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?

Permitting entities that are listed, but do not have a full equity listing, with existing quoted securities (such as debt listings or foreign exempt listings) may, in certain circumstances, permit an new class of eligible issuer to take advantage of any new rules. In particular, it may be appropriate to permit Australian investors the ability to invest in certain high quality off-shore issuers.

Investors in the Australian wholesale / institutional market currently invest in such "kangaroo" issuers. In 2010, approximately A$36.6 billion of kangaroo bonds were issued into Australia, and A$28.7 billion in 2011. Some of these bonds were listed on the ASX debt board.

We can see advantages in Australian investors having the ability, subject to certain conditions, to also invest in such bonds much as Australian corporations access off-shore retail corporate bond markets for funding.

However, as a policy matter, this short form disclosure should not be extended to entities that are not already disclosing entities under Part 1.2A of the Corporations Act, except in very limited circumstances (if at all). The initial public offer prospectus provides an important introduction of the entity to the market. However, it may be appropriate to have some limited relief to facilitate foreign entities already listed on foreign exchanges to issue in this market.

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. As noted in the Discussion Paper, we assume that the relevant financing company subsidiary would be guaranteed by the listed parent and that the listed parent would also be making all appropriate continuous disclosures. This would also be consistent with the existing financing structures of many large issuers, and promote consistency with the structures and processes that are already followed for wholesale debt issuance.

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?

It appears to us to be unnecessary, in circumstances where the modification has been fully disclosed to the market. It is not, for instance, a requirement for the use of transaction-specific prospectus disclosure (under section 713) or cleansing notices for equity issuance.

It would, however, be appropriate for ASIC to have a power to withdraw the benefit of the provisions for a particular issuer, in similar circumstances to those in which ASIC may issue a determination that issuers may not use cleansing notices or transaction-specific prospectuses.

PROPOSED ENTRY REQUIREMENTS / ELIGIBILITY - CONDITIONS RELATED TO THE BOND

Are the proposed conditions set out above appropriate?

Yes.

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?

Yes. The issue of subordinated bonds should be permitted under the proposed new short form prospectus regime. We believe that this flexibility is important to the likely usage of the proposed reforms.

Issuers are already entitled to issue subordinated bonds pursuant to a prospectus that complies with Part 6D.2 of the Corporations Act. This suggests that, with appropriate disclosure, investors will have sufficient information in order to make a decision as to whether or not to invest in such products.

As a general observation, the key principal behind the proposals in the Discussion Paper are as to allowing continuously disclosing entities a more streamlined process for accessing the market on the grounds that appropriate information with respect to the eligible issuer itself is freely available. Provided that the nature and terms of the instruments are appropriately disclosed in the Base Prospectus, then we do not believe that there should be any grounds to limit certain features of bonds that are already regularly issued into both the domestic wholesale / institutional market without a Chapter 6D compliant prospectus as well as into the domestic retail market pursuant to a Chapter 6D compliant prospectus.

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

Yes.

Investors will always at liberty to sell their bonds on-market should they wish to exit their investment, if the market has established sufficient liquidity. Investors in other fixed income products (such as term deposits or unit trust investments) are also able to choose their preferred term. Subject to appropriate disclosure as to the relevant term of the instrument and the risks of selling a bond at the then current market price, we see no reason as to why longer dated instruments should not be permitted. Flexibility as to term will:

- allow investors to better match their own investment priorities and desired outcomes with appropriate products; and

- in all events be dictated by the market. That is, there will be investor appetite for longer dated bonds for the reasons noted above, in which case, they should be permitted. If there is no investor appetite then longer dated bonds will not find a ready market and will not be issued on terms mutually acceptable to both issuers and investors.

In addition, long dated government bonds have historically been available and, as a product class, there is no obvious reason as to why these should not also be available from corporate issuers.

In addition, a limit of this kind would not facilitate the issuance of bonds which also provide issuers with some ratings benefits, such as equity credit treatment – and that has been one of a number of factors influencing recent retail bond issuance. However, those bonds may be more complex than the products contemplated by Treasury's reform (although there remains no issue in principle why those products should be issued under a section 710, rather than section 713 transaction-specific prospectus).

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

Yes, although it may not be appropriate to permit highly complex deferral triggers.

Issuers are already entitled to issue bonds with terms that provide for the deferral of interest pursuant to a Chapter 6D compliant prospectus. This suggests that, with appropriate disclosure, investors will have sufficient information in order to make a decision as to whether or not to invest in such products.

In addition:

- subordinated bonds issued by APRA regulated entities for regulatory capital purposes may be required to include such features. Such bonds have been part of the Australian retail bond landscape for some time and it should be expected that investors are familiar with such features; and

- there are other examples in the retail bond market of instruments with interest deferral features having been issued by other (non-regulated) entities.

As a general observation, and as noted above, it seems to us that the key principal behind the possible changes proposed in the Discussion Paper are as to allowing continuously disclosing entities a more streamlined process for accessing the market on the grounds that information with respect to the eligible issuer itself is freely available. The terms of the bonds themselves will be laid out and disclosed in the Base Prospectus thus ensuring appropriate investor protection in a manner that is entirely consistent with the existing Chapter 6D regime in this respect.

However, please note our observations below on more complex instruments (which may include those with sophisticated deferral triggers).

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?

As above, appropriate disclosure should be included in the applicable Base Prospectus. However, the necessary risk disclosures should not, of themselves, be especially lengthy nor add complexity to the document. It should be entirely possible to explain the risks of such terms in a clear and concise manner. Any applicable risk factors in respect of binds with such features could be given an appropriate degree of prominence such that investors are clearly aware of any relevant risks.

However, for products that are more complex, as a policy matter it may be appropriate to encourage (and permit) the use of transaction-specific prospectuses under section 713, rather than the shorter form of vanilla bonds prospectus. As noted above, even for more complex bonds, there is no justification for requiring a section 710 initial public offer prospectus in circumstances. We note that other complex products, with equity conversion features, can use transaction-specific disclosure.

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?

This can be managed with appropriate disclosure.

It is important that the types of bonds that can be issued be correctly described. However, in this regard, and in the European market, "Base Prospectuses" that permit retail issuance are able to describe a range of bonds with terms such as subordination, interest deferral and a wide spectrum of even more complex features.

We see no reason as to why certain mandated terms could not be used for particular products types. For example, a bond that describes itself as a "fixed rate subordinated bond" must confirm to certain characteristics such that investors are able to quickly and easily compare and contrast product types across different issuers. Bonds that fall outside agreed eligibility criteria would not be able to take advantage of the shorter form prospectus regime. However, see our comments above in relation to transaction-specific disclosure for complex bonds.

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?

We do not believe that the mere inclusion of a credit rating will (or indeed should), of itself, mean shorter disclosure. In particular, given that an investor is not allowed to rely on a rating ultimately means that, investors need to consider all available information for themselves (much as they would for an equity investment).

However, inclusion of a credit rating requirement would be helpful and in many cases, important:

- a rated issuance will provide investors with an independent opinion of credit risk which can be used as a benchmark to compare and contrast alternative products;

- institutional and sophisticated investors seek ratings information, and many clearly regard it as relevant and important (although we note that there are mixed views on this);

- if significant ratings information can be provided to institutions but not provided to retail investors there is an asymmetry of information which is at odds with the principles underpinning Australia's disclosure regime. Suggestions from some stakeholders that retail investors can, if they wish, go looking for ratings information about the issuer is not a valid or appropriate response to this concern;

- a rated issuance will encourage the participation of institutional investors in respect of particular offerings and in the development of the market generally;

- ratings need to be understood by the market - they are not a guarantee by the ratings agency of the issuer's credit standing, but there are few (if any) other proxies for that information that are readily accessible to and understood by retail investors; and

- anecdotal evidence suggests that retail investors are heavily influenced by brand perceptions of issuers, but in some cases ratings information can give a perspective on some well known or high profile brands that would encourage caution.

Absent a credit rating being assigned to any particular retail issue, institutional investors may be reluctant or unable to (by operation of an internal mandate or investment preference) invest in that offering and, consequentially, cornerstone investors may be difficult, if not impossible, to engage.

However, we understand that there is a range of perspectives in the market as to the importance of ratings information – some regard it as fundamental information, others say that it is not critical. We suggest that interested parties continue to discuss how best to balance the role of rating agencies in the market generally. While it would, in our view, be desirable to find a solution to the current issues, resolution of these issues should not hold-up progression of the reforms proposed by the Discussion Paper.

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

As above.

We recognise that there presently exists an unresolved situation as regards credit rating agencies in relation to Australian financial services license ("**AFSL**") requirements for the presentation of credit ratings to retail investors (other than Australian Ratings). We are not at liberty to comment, in this paper, on that situation. However, we would encourage direct engagement with the various ratings agencies and ASIC on the issue to obtain a balanced understanding of the situation, and explore potential paths for resolution or compromise that might deliver a more satisfactory outcome for retail investors

GENERAL APPROACH TO CONTENT REQUIREMENTS AND PROSPECTUS LENGTH

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

Yes, although this is not an approach that we would recommend for other kinds of prospectuses.

In our view, recommending a list of headings will assist investors to compare and contrast vanilla debt products and issuers.

However, to avoid some of the disadvantages of the product disclosure regime (which has evolved into highly prescriptive content requirements) we would suggest that the "prescribed" content could be by way of policy to allow for some ability to adapt to evolution of the market, and to avoid inappropriate disclosure in some cases. Alternatively, prescribing content by way of regulation may at least increase the flexibility of updates to the requirements.

There should be power for ASIC to waive or modify requirements, upon application, in appropriate cases.

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?

We do not believe that mandating a maximum length is appropriate. However, we do believe that once the content has been prescribed (including specified headings) then the market will gravitate toward an appropriate length for offerings that take advantage of the proposed reforms. This will allow investors to easily compare and contrast issuers and products. We suspect that this will be around 40-50 pages. However, where an issuer believes that additional disclosure is important in its particular circumstances, it would be inappropriate to restrict that disclosure by application of an arbitrary page or word limit.

We note that with formatting and other drafting changes, a pure "page length" model could be easily circumvented and would lead to inappropriate disclosure practices.

However, it would, be highly desirable to have greater flexibility to incorporate information by reference – including information that is capable of being updated without revision of the prospectus (such as annual reports and financial statements).

Finally, we note that it is problematic to impose page limits or content restrictions on issuers without also providing a safe-harbour from liability for information excluded in good faith in order to comply with those restrictions.

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

Yes.

We have worked on many of the landmark retail bond transactions in the market, and would be happy to assist and work with other interested parties in the preparation of such a 'model' Base Prospectus and Pricing Supplement or cleansing notice.

CONTENT REQUIREMENTS - INVESTMENT OVERVIEW

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

Yes. The proposed headings are suitable, subject to the following provisos:

- the headings need to be tailored to the fact that the Base Prospectus will be "live" for a specified period (i.e., up to 2 years). Consequently, the information included will, in some parts, be general in nature (i.e., as to what will happen in respect of each issue) rather than specific (i.e., in respect of a particular issue). See also below; and

- section 6 (summary financial position) need not be included on the basis that all of this information could be incorporated by reference to publicly available financial information that the eligible issuer already files as part of its continuous disclosure obligations. This would (i) be consistent with the themes of the Discussion Paper and (ii) help limit the length of the Base Prospectus. However, a clear statement as to how and where investors can find such financial information (including that hard copies are available on request) should be included.

Would an investment summary be a useful inclusion?

In some cases, yes – subject to our comments below.

The inclusion of such a summary needs to be considered in light of the fact that a summary, by its very nature, must be subject to the balance of the Base Prospectus and Final Terms. In addition, this will increase the length of the document more generally and will tend to lead to repetition.

For instance, ASIC RG228 requires the inclusion of an Investment Overview in many prospectuses. It is not required for more 'routine'' fundraising under a transaction specific prospectus. In practice, where Investment Overviews are used, they require a substantial amount of information to be included in the summary. Given the format and content suggested for the Base Prospectus – such a summary may simply be repetitive and not improve the overall accessibility of the document.

It would be appropriate to suggest, but not mandate, the inclusion of a summary.

- DETAILED CONTENTS

Are the content requirements suggested appropriate?

Yes.

However, where the modified shelf prospectus proposal is used:

- **section 1** - inclusion of a timetable needs to be considered in light of the fact that the Base Prospectus may be valid for multiple offers during its life span. The timetable will need to be sufficiently descriptive to cover this;

- **section 2** - inclusion of a section as to the amount to be raised also needs to be considered in light of the fact that the Base Prospectus may be valid for multiple offers; and

- **section 3** – some of the information proposed would more properly be incorporated in the Pricing Supplement for each particular issue (i.e, term, amount, rate, interest payment dates). However, this section would specify the common or base terms that apply to all issues under the particular Base Prospectus and should confirm that any variable administrative, operational or pricing information would be set out in the Final Terms.

These issues would tend not to affect a Base Prospectus used only for an initial vanilla debt offer, with subsequent offers made under cleansing notices.

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

The content requirements are appropriate.

Could section 4 be merged with section 3?

No. We think that sections 3, 4 and 5 are each stand-alone sections.

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?

No. We do not believe that it is appropriate to include such a statement. It is difficult to envisage a situation where an entity would ever note that it is incapable (or has a compromised capacity) of meeting its obligations under the bonds. Consequently, we think that any such statements would be practically meaningless and potentially misleading.

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

We are not in favour of including financial metrics in the prospectus. Please see reasons outlined below.

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?

Whilst the requirement for the presentation of financial metrics may be aimed at equipping investors with a baseline of information upon which they are to perform a credit risk comparison between eligible issuers, we do not believe that the summary information provided by such metrics is an appropriate credit analysis for retail investors who would then be expected to make an investment decision based solely on the basis of those metrics. That is, to give such metrics a prominence in an offering document suggests that they are the appropriate (and possibly only) grounds on which to base an investment decision.

In addition, this question raise also needs to be considered in light of the role of credit ratings and their role as an assessor and communicator of credit risk.

Finally, there is also an underlying assumption that the financial metrics are a sufficiently targeted or, in the case of financial metrics to be prepared by an eligible issuer itself, an unbiased tool that allows an investor to perform a meaningful credit risk comparison between issuers.

In the case of bonds that could take advantage of the proposed reforms, the Base Prospectus will, in all events, be supplemented by information released to the market as part of the eligible issuer's continuous disclosure obligations, which should provide sufficient price discovery mechanisms to help investors establish the value of their bonds on an ongoing basis (in the same way as equity investors are able to access such information).

This is consistent with one theme of the Discussion Paper that investors should be encouraged to take an active role in seeking information about products and should also take ultimate responsibility for their financial decisions (albeit without leaving the burden of analysis to be borne solely by investors).

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;***

Yes. It would be appropriate that all issues, intermediaries, regulators and other interested parties be aware that of the policy objectives. However, unless there is a corresponding safe-harbour from liability, this statement may place issuers in an unfair position and should be issued as policy rather than a legislative provision.

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

Yes – as an optional measure. Where this is encouraged, this information should also be available (on request) in hard-copy format for those investors who do not have access to the internet.

Where information is included on a website – there needs to be a clear statement that investors will be taken to be aware of it, for the purposes of the issuer's liability. It would not be appropriate for issuers to bear increased risk of liability, by adopting a disclosure method that has been encouraged by the legislature.

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

Yes. We agree that this is an appropriate approach that will help minimise costs for issuers. We note that companies can issue equity securities with no disclosure as to the tax consequences for an investor.

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

We believe that this should be encouraged. This will have the twin advantages of assisting with shorter disclosure documents as well as maximising up-to-date disclosure. It should be permissible to refer to annual reports and financial statements in such a way that updates to those documents are captured without requiring a revision to the prospectus.

- ***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 that this would be of assistance and should be encouraged. We encourage consultation with industry experts, in the course of preparing publications of this kind.

Issuers should not be required to obtain consent in order to refer to publications prepared for this purpose, nor should they bear liability for the contents of those publications.

OTHER DISCLOSURES

Will retail investors benefit from reading these reports [being quarterly reports under s 283BF, half-year and annual 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?

We do not see that the investor protections provided by Chapter 2L of the Corporations Act are in need of expansion from those measures considered by the legislature to be required. In particular, we believe that the quarterly reporting requirements of section 283BF are sufficient and are not benefited by the proposal to require additional quarterly reports.

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?

We strongly support both proposals.

As noted above, we consider that a 'modified shelf' approach using a Base Prospectus with a shelf life of up to two years, updated:

- by continuous disclosure during its life span; and
- by a Pricing Supplement for any particular issue of bonds,

would be a significant advance on the current disclosure model. However, we consider that a streamlined Base Prospectus, with subsequent offers made under a cleansing notice in the context of ongoing continuous disclosure would have a broader appeal for a range of companies and is consistent with Australia's current disclosure regime. Accordingly, we urge the consideration of the cleansing notice model.

What is the basis for your view?

In our view, the ability of an issuer to prepare a base prospectus which is updated through continuous disclosure and/or can be separately supplemented throughout its lifespan in respect of each issuance of eligible bonds, and which is effectively subject to a periodic (two year) update, would potentially create the necessary short and medium-term costs benefit for a great number more issuers to justify the establishment of a standing "programme" for the issuance of retail debt, meaning that the pool of issuers with a consistent eye on the retail debt market is expanded. There is also widespread acceptance of this offering method, domestically in the wholesale / institutional market and internationally.

However, this is not a path that will appeal to smaller issuers. We consider that the cleansing notice alternative is viable, and offers advantages in terms of cost, flexibility and familiarity with existing disclosure practices.

One of the defining features of the Australian domestic wholesale bond market and the international wholesale and retail capital markets is speed to market. While any retail offer will still have a longer offer period than a wholesale offer, both of these mechanisms would result in significant improvements in speed to market compare to current retail bond offers.

What should be the maximum life of a base prospectus?

Mallesons supports the current maximum life for a Base Prospectus of 2 years for a "modified shelf" prospectus. We note that, for the cleansing notice alternative – it is not necessary to vary the maximum life of the 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?

As noted above. The Pricing Supplement or cleansing notice could contain very similar information – but each should be capable of being a very short document, by comparison to the Base Prospectus.

INCORPORATION OF INFORMATION BY REFERNECE

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.

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)?

Yes. This is a complex issue, as it is important that there should be accountability for company information that supports an offering – but at the same time, imposing additional layers of liability on information that is already in the public domain will increase the cost and process associated with vanilla debt issues.

LIABILITY FOR PROSPECTUS CONTENT

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

We strongly support the removal of deemed personal liability for directors in connection with prospectuses. In our view, the concern over personal liability for individuals can tend to encourage an undue emphasis on process, rather than streamlined issues-focused due diligence. It also is inconsistent with the appropriate role of boards in modern corporations. The imposition of "deemed" liability (irrespective of involvement in the actual contravention) places directors in a position where they must then make out a "due diligence" or "reasonable reliance" defence. Separately directors must also demonstrate that they have taken "reasonable steps" to ensure that the document was not misleading or deceptive. Each of these measures requires an active and direct involvement in due diligence processes that is time-consuming, that slows speed to market, and that is inconsistent with the proper responsibilities of directors.

This is not to say that directors should not have any role in the issue of prospectuses or responsibility for some statements in prospectuses – but it should be consistent with their broader functions as a board and the division of responsibility between board and management.

The proposed reforms would remove deemed civil liability under section 729 of the Corporations Act. We strongly support this initiative, and note that it would not absolve directors from all responsibility for the prospectus – but would align it more closely to their proper level of involvement.

We would also strongly recommend that other elements of the Corporations Act that require the direct involvement of boards in even routine fundraising under a simple prospectus be re-considered.

For instance, the requirement for all directors to consent to the issue of a prospectus – even for routine fundraising – triggers the application of an obligation on each director to personally ensure that reasonable steps are taken to ensure that the prospectus is not misleading or deceptive. Failure to take such steps is a criminal offence, and any liability depends on both physical elements and fault elements being established, including elements of intention (regarding taking steps) and recklessness (in relation to the circumstances of the document being misleading and deceptive). While those elements are difficult to establish – a failure to be directly involved in a due diligence process of some kind would significantly raise the risk of an offence being made out. Directors are not exposed to this risk in wholesale fundraising, beyond general directors duties obligations. We submit that directors general duties are sufficient.

We suggest the removal of the consent obligation, or an express acknowledgement that directors may delegate responsibility for due diligence processes, and rely on others, as a form of defence to criminal liability, to address this position. This would not absolve directors from all sources of criminal liability for prospectuses, as they would remain liable for any accessory involvement in an offence by the company (which would, appropriately, require knowledge of all the elements of the offence).

We believe that the reforms proposed would allow a more flexible approach to due diligence, where enquiries could be tailored having regard to the nature and significance of the offering, and the significance of any accompanying disclosures – in line with directors' general duties. For routine fundraising within parameters approved by the board, it would permit due diligence processes to more closely align with those followed for wholesale issuance.

In our view, some improvements to the efficiency of due diligence processes could be achieved by the removal of deemed civil liability for directors. However, the existence of criminal liability that is focussed on process, rather than substantive involvement, may make boards and their advisers reluctant to adopt different processes.

EXEMPTION FOR PRUDENTIALLY REGULATED ENTITIES

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

No.

We see no reason why the relief available for prudentially regulated entities should be removed. It would not be appropriate to limit the means by which ADIs can raise capital, or to introduce process constraints for ADIs to raise capital.

The issue of retail bonds under section 708(19) would facilitate the growth of the retail bond market. The 2011 retail bond issue by CBA was conducted under section 708(19), and represented a positive example of disclosure that is consistent with the aims of the proposed reforms. We have not observed any abuse of section 708(19) that would warrant its removal.

APPLICATION AND TRANSITIONAL ARRANGEMENTS

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

We see no reason as to why a transitional period is required. There are no reasons as to why any proposed changes to the law could not take effect at any time following enactment of appropriate legislation.

CONCLUDING COMMENTS

We consider that the proposed reforms are significant and are appropriate measures to assist to stimulate the development of a retail bond market in Australia. We would be happy to discuss any of the comments we have made in this submission.

Mallesons Stephen Jaques
16 February 2012