REGULATORY GUIDE 69

Debentures and notes: Improving disclosure for retail investors

February 2012

About this guide

This guide is for issuers and others involved with the issue of mortgage debentures, debentures, secured notes, and unsecured notes or unsecured deposit notes.

It sets out our guidelines for disclosure to retail investors to help them understand and assess unlisted debentures and notes, while maintaining the flexibility of the public fundraising process. It also provides guidance on how debentures and notes may be described.

> Note: See also Regulatory Guide 156 *Advertising of debentures and notes to retail investors* (RG 156).

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This version was issued in February 2012 and is based on legislation and regulations as at that date.

Previous versions:

- Superseded Regulatory Guide 69, issued October 2007, reissued August 2008 and June 2010

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

A Overview

Key points

This guide applies to issuers of unlisted ‘mortgage debentures’, ‘debentures’, ‘secured notes’, and ‘unsecured notes’ or ‘unsecured deposit notes’: see RG 69.1–RG 69.3.

The risk features of notes and their appeal to ordinary retail investors require an improved approach to disclosure: see RG 69.4–RG 69.6.

ASIC has developed eight benchmarks that can help investors understand the risks, assess the rewards being offered and decide whether these investments are suitable for them: see RG 69.7–RG 69.8. An issuer of unlisted notes should address the benchmarks in its disclosures on an ‘if not, why not’ basis, and ensure that their advertising is consistent with these disclosures: see RG 69.9–RG 69.10.

Those parties involved with issuers (e.g. trustees, auditors and valuers) should use the benchmarks and the ‘if not, why not’ explanations in carrying out their responsibilities: see RG 69.11.

This guide also provides guidance to all issuers of notes (whether listed or unlisted) on how these products may be described consistently with s283BH of the *Corporations Act 2001* (Corporations Act): see RG 69.2.

Who this guide applies to

RG 69.1 This guide applies to issuers of unlisted ‘mortgage debentures’, ‘debentures’, ‘secured notes’, and ‘unsecured notes’ or ‘unsecured deposit notes’. These products are interchangeably referred to as ‘notes’ in this guide.

> Note: See s283BH of the Corporations Act, Class Order [CO 12/1482] *When debentures can be called secured notes* and Section G of this guide for information on how these products may be described.

RG 69.2 We expect issuers of unlisted notes to follow the guidance and expectations in this guide. We expect issuers of listed notes to follow the guidance on the naming of notes set out in Section G.

RG 69.3 Apart from Section G, this guide does not apply to:

(a) issuers of notes that were not required to follow the guidance when RG 69 was first introduced in October 2007;

(b) initial public offerings under a prospectus that states that the offered notes are to be quoted on a financial market. This guide will apply, however, if that prospectus is varied by a supplementary or replacement prospectus indicating withdrawal of the intention to quote the notes on a financial market. For further information, see Regulatory Guide 99

Quotation of securities offered by prospectus (s1031) (RG 99) and s723(3) of the Corporations Act; or

(c) any notes that are convertible into listed securities at the discretion of the investors.

Improving disclosure to retail investors

RG 69.4 Notes held by retail investors are used as a source of finance for a range of business models and activities. With notes, the investor provides loan funds to the issuer, and in return the person borrowing the funds (the issuer) issues a note with a promise to pay a rate of interest (usually fixed) for a defined term, and then repay the loan.

RG 69.5 Some features and risks common to notes and their issuers can create risks for investors. This is particularly the case for notes that are not quoted on a public market ('unlisted' notes): see Section B. A lack of clear benchmarks can also make it hard for investors to adequately understand, assess and compare these securities.

RG 69.6 We have identified four guiding principles for improved disclosure by issuers of unlisted notes, which are designed to provide for better risk assessment by retail investors: see Table 1. These principles are the foundation for our approach in this guide.

Table 1: Guiding principles for improved disclosure on unlisted notes

What the principle is	Related information
Principle 1: Benchmarks can help retail investors assess the risk and risk–reward prospects of notes.	See Section C of this guide.
Principle 2: Issuers of unlisted notes should disclose against the benchmarks on an 'if not, why not' basis, and ensure that their advertising is consistent with these disclosures.	See Section D of this guide and Regulatory Guide 156 *Advertising of debentures and notes to retail investors* (RG 156).
Principle 3: Those parties involved with issuers (e.g. trustees, auditors and valuers) should use the benchmarks and the 'if not, why not' explanations in carrying out their responsibilities.	See Sections E–F of this guide.
Principle 4: Additional education will assist investors and potential investors in the unlisted note sector, including by helping them understand and use the benchmarks and the 'if not, why not' responses in their investment decision making.	See our investor guide, *Investing in unlisted debentures and unsecured notes?* Note: We will update our investor guide shortly to reflect the introduction of the 'secured notes' category discussed in Section G.

Benchmarks for unlisted notes

RG 69.7 We have developed eight benchmarks that apply to unlisted notes: see Table 2 and Section C. Some benchmarks apply to all issuers; others apply only to certain issuers. We expect issuers to disclose against the benchmarks (as applicable) on an 'if not, why not' basis: see RG 69.9–RG 69.10. We also expect any advertising to support the use of these benchmarks: see RG 156.

RG 69.8 Failing to meet one or more of these benchmarks does not mean that a particular note is necessarily a poor investment—however, additional disclosure to investors will be needed to address that benchmark on an 'if not, why not' basis so that investors can assess its impact on their investment decision.

Table 2: Benchmarks for unlisted notes

General benchmarks for all issuers of unlisted notes	**1 Equity ratio**	Benchmarks 1 and 2 address the issuer's financial structure and ability to meet loan obligations on time.
	2 Liquidity	
	3 Rollovers	Benchmark 3 addresses the transparency of the issuer's approach to 'rollovers' of investments.
	4 Debt maturity	Benchmark 4 addresses the debt maturity profile of the issuer and associated interest rates.
Additional benchmarks for lenders	**5 Loan portfolio**	Benchmark 5 addresses the issuer's lending practices.
	6 Related party transactions	Benchmark 6 addresses a specific area of lending risk.
Additional benchmarks for property-related notes	**7 Valuations**	Benchmarks 7 and 8 address the issuer's property-related practices.
	8 Lending principles—Loan-to-valuation ratios	

Disclosure against the benchmarks: 'If not, why not'

RG 69.9 Issuers of unlisted notes should disclose against the benchmarks on an 'if not, why not' basis: see Section D. This means stating that the issuer and product either:

(a) meet the benchmark; or

(b) do not meet the benchmark *and* explaining how and why the issuer deals with the business factors or issues underlying the benchmark in another way.

RG 69.10 Disclosure against the benchmarks should be:

(a) addressed up-front in the prospectus;

(b) updated in ongoing disclosure as material changes occur—for example:

(i) in a replacement prospectus, supplementary prospectus or continuous disclosure notice; and

(ii) at least twice a year, in quarterly reports to trustees; and

(c) supported in, and not undermined by, advertising material.

Other participants involved with unlisted notes

RG 69.11 We expect other parties involved with issues of unlisted notes to support the guiding principles in Table 1: see Sections E–F. This includes trustees, auditors and valuers.

Underlying principles

RG 69.12 The disclosure framework in the Corporations Act requires issuers of financial products who seek retail investors to:

(a) disclose up-front to these investors all they need to know to make prudent decisions in their own interest; and

(b) provide ongoing disclosure to help retail investors monitor whether their expectations are being met.

Note: For notes, the framework provides an additional safeguard by requiring that there be a trustee for note holders: see Section E.

RG 69.13 In recent years, there have been a number of market failures in the note sector, including unlisted notes. If the funds invested in failed unlisted notes were raised in professional markets or provided by professional investors, their commercial failure would be of less concern to ASIC or the broader community. In an open economy, such as that in Australia, business failure is accepted as an inevitable result of a competitive environment.

RG 69.14 What is of concern is the combination of the risk features of these types of investments (see Section B) and their appeal to ordinary retail investors.

RG 69.15 The regulatory framework places special emphasis on the needs of retail investors, and makes disclosure the key tool for them. Disclosure is not designed to stop retail investors from taking investment risks, but to help them understand the risks involved in any particular investment or type of investment. This enables them to make an informed decision about whether the potential reward (the return on their investment) matches the level of risk involved, and whether they are prepared to take on that risk.

RG 69.16 This assessment is particularly important and difficult if investors need to consider not only underperformance risk (the risk that an investment will not produce returns as high as expected), but also the risk of significant or total loss of the original investment funds. For notes, typically the return is fixed because the issuer promises to pay interest on the loan at a fixed rate. Therefore, the issuer's ability to repay the funds lent (credit risk) is usually the most critical risk.

RG 69.17 We believe that our approach balances:

(a) the need to improve disclosure to allow investors to make informed decisions; and

(b) the desirability of not unduly interfering with this market as a market for raising capital.

Note: The need to strike an appropriate balance between protecting investors' interests and allowing markets to operate freely is part of ASIC's mandate under the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

RG 69.18 Our approach cannot prevent investments failing, nor ensure that they perform to investors' expectations. However, better disclosure can help investors make better risk–reward decisions.

RG 69.19 Our approach should not result in longer disclosures. Recent experience shows that investors need better quality and relevant disclosure, presented in a way best suited to investor understanding.

B The unlisted note sector

Key points

Notes held by retail investors are used as a source of finance for a range of business models and activities: see RG 69.20–RG 69.21.

Some features of unlisted notes and their issuers can create risks for investors, and a lack of clear benchmarks can make it hard for investors to adequately understand and assess these products: see RG 69.22–RG 69.30.

Business models and activities

RG 69.20 Capital markets provide funds to enable companies in the real economy to innovate and take commercial risks without certainty of return.

RG 69.21 Notes held by retail investors are used as a source of finance for a range of business models and activities, and have been part of capital markets for a long time. Uses of capital raised in this way include:

(a) *debt capital funding*—money raised and applied as working capital or transaction-specific funding to further the issuer or group's business operations;

(b) *finance*—lending for personal and general commercial purposes;

(c) *integrated property*—funding of property transactions and development within a group or with related parties where that amount of funds applied is greater than 10% of the total assets of the note issuer;

(d) *mortgage financing*—secured mortgage lending for residential and commercial property ownership and improvement, with security over real property;

(e) *structured real estate investments*—participation in ownership of commercial and residential real estate as part of a wider ownership structure; and

(f) *memberships*—notes issued to facilitate membership of clubs, groups or franchise operations.

Risks to investors

RG 69.22 In recent years, there have been a number of market failures in the note sector, including unlisted notes. A large number of investors have faced potential losses of significant amounts of money.

RG 69.23 We have analysed the common features of those failures. This analysis has identified the key features and risks common to those failed entities: see Table 3. These features are not present in every issue of notes to retail investors. The investment risks described will vary from issuer to issuer and from business model to business model. However, disclosure about these features and risks, including to what extent they are present in a given offering, is desirable for a broad range of notes.

Table 3: Common risk features of unlisted notes

Risk feature	Description	What this means
Minimal equity capital	The note issuer frequently has little equity capital relative to the loan funding it relies on to operate its business (loan funds include both funds borrowed from a lending institution and funds contributed by note holders).	The owners of the entity that issues the notes have little capital at risk compared to note holders and other lenders. This arguably means they have less incentive to ensure the prudent management of the business, and also that their interests and those of note holders are not well aligned. If an investment runs into difficulties, there is no source of funds to tide the investment over, other than by raising further investment funds.
Liquidity	The liquidity of the issuer is key to its ability to meet its obligations to pay interest and principal to note holders on time.	Liquidity is often at risk because of a mismatch between the timing of the issuer's obligations to repay note holders, and the timing of cash flows from the underlying businesses or assets to which funds have been on-lent. Liquidity is frequently heavily dependent on continuing inflows from new investors, or 'rollovers' by existing investors. This problem is exacerbated if inadequate disclosure in a prospectus leads to ASIC halting further fundraising by issuing a stop order. The issuer can then no longer rely on an inflow of funds from new investors. This may worsen its liquidity and in extreme cases threaten its solvency.
Loan assessment and diversification	The criteria issuers use to decide what loans to make are extremely variable and prone to risk, especially in the following key areas: • loan-to-valuation ratios are often much higher than for traditional lending; and • the loans issuers make may be highly concentrated to particular types of assets, commercial activities, locations or borrowers.	In many cases, the note issuer's loan book exposure is not diversified. Lack of diversification means there is greater risk that an adverse event affecting one borrower or one type of loan will simultaneously affect the majority of borrowers, and therefore put the overall portfolio at risk.

Risk feature	Description	What this means
Inconsistency in valuations	The valuations lenders rely on are carried out on a variety of bases, with differing assumptions and instructions.	This makes it difficult to assess reliably the risk exposure associated with a loan, and difficult to monitor loan-to-valuation ratios on a continuing basis.
Related party lending	Funds raised through notes are often on-lent to companies or businesses associated with the note issuer.	There is an increased risk that lending decisions will not be made on arm's-length commercial terms, and that the note issuer who makes the loans will not monitor performance by the borrower as rigorously as it would in an arm's-length transaction.
Misleading advertising	Advertising used to promote some notes helps create unrealistic expectations about the relative safety of the notes.	Even if the prospectus disclosure highlights risk in an appropriate way, advertising that conveys messages not in line with the regulated disclosure document can undermine the effect of that disclosure.

RG 69.24 Unlisted notes pose particular challenges because retail investors who hold these types of securities do not have the benefit of price discovery mechanisms and market forces to:

(a) help them work out the value of their securities on an ongoing basis;

(b) monitor and publicise the ongoing performance of the issuer (through a licensed market's continuous disclosure regime); and

(c) provide them with a reliable way to exit their investment efficiently.

RG 69.25 Being unlisted means there is no liquid secondary market on which an investor can sell an investment that is no longer required, or in which the investor has lost confidence. Some note issuers offer early exit mechanisms, but these are likely to be unavailable if the issuer is in financial difficulty.

RG 69.26 Being unlisted also means that there is no market supervisor to:

(a) initially assess and, if appropriate, admit the issuer's securities to trading; and

(b) supervise the issuer's ongoing compliance with any listing rules—in particular, a continuous disclosure regime.

RG 69.27 The absence of a market listing exacerbates the risk that key new information about the performance of the issuer may not be communicated to existing investors. This is of particular concern given that the Corporations Act does not require that existing investors receive a prospectus before rolling over their investment or making a further investment in the issuer's notes: see s708(14) and RG 69.45.

RG 69.28 Typically, there are few external benchmarks retail investors can use to assess and understand the risk of the investment, and the value of the notes they may subscribe for. In particular:

(a) retail investors cannot obtain and rely on research prepared by market professionals (such as analysts) or the coverage the financial media provides for many listed securities;

(b) few retail adviser groups conduct detailed research on individual note products; and

(c) retail investors do not have a way of assessing the market value of their investment, and of monitoring the ongoing performance of the issuer, as reliably as they would have if these products were listed and traded on a regulated financial market (and were therefore subject to the relevant supervision and continuous disclosure regime).

RG 69.29 Risks are most significant where funds are on-lent for the development of property assets. Reasons include that there is often no cash flow to meet obligations until after a development has been completed and can be sold. In these circumstances, there is likely to be greater uncertainty about whether properties can be completed and sold for anticipated values; and if further loan investments are needed to complete development projects, the overall viability of the venture may be doubtful because interest costs for the project will increase.

RG 69.30 Nonetheless, the features described in Table 3 are present, or potentially present, to varying extents in many forms of note investments. For example:

(a) the underlying business models of property development issuers share some features with other note issuers who on-lend funds to third parties;

(b) many types of note issuers have low levels of equity capital; and

(c) many types of note issuers have some degree of mismatch between the maturities of their assets and liabilities, making them vulnerable to liquidity problems in adverse market conditions.

C Benchmarks for unlisted notes

Key points

All issuers of unlisted notes should address general benchmarks on:

- equity ratio (see RG 69.31–RG 69.34);
- liquidity (see RG 69.35–RG 69.42);
- rollovers (see RG 69.43–RG 69.46); and
- debt maturity (see RG 69.47–RG 69.49).

Issuers of unlisted notes who lend money should address additional benchmarks on:

- loan portfolio (see RG 69.50–RG 69.59); and
- related party transactions (see RG 69.60–RG 69.63).

Issuers of unlisted notes involving property should address additional benchmarks on:

- valuations (see RG 69.64–RG 69.69); and
- lending principles—loan-to-valuation ratios (see RG 69.70–RG 69.75).

Benchmark 1: Equity ratio

RG 69.31 An issuer should use the following equity ratio benchmarks:

(a) where more than a minor part of the issuer's activities is property development or lending funds directly or indirectly for property development—the issuer should maintain a minimum equity ratio of 20%;

(b) in all other cases—the issuer should maintain a minimum equity ratio of 8%;

(c) the issuer's equity ratio should be calculated as follows:

$$\frac{\text{total equity}}{\text{total liabilities + total equity}}\text{; and}$$

(d) the issuer should disclose its comparative equity ratio from the prior year.

Note 1: 'Equity' and 'liabilities' have the meanings given under the Australian accounting standards.

Note 2: The comparative equity ratio should be from a date approximately 12 months prior to the current equity ratio.

Explanation

RG 69.32 Paid-up capital or equity is the money invested by the owners of the issuer (plus any profits retained by the issuer). It provides a 'buffer' to the issuer in the event of financial difficulties, and it also provides the issuer's owners with an incentive to operate prudently and responsibly (sometimes referred to as 'hurt money' or 'skin in the game'): see 'Minimal equity capital' in Table 3.

RG 69.33 Insufficient capitalisation appears to be a contributing factor in each of the failures of unlisted note issuers in recent years. Where involved in property development, the issuer is more vulnerable to adverse market movements and at higher risk of financial distress. Therefore, this benchmark has a higher minimum capital requirement where more than a minor part (e.g. 10%) of the issuer's activities (e.g. as a proportion of notes on issue) is related to property development. If this capital is not present, investors should be informed (on an 'if not, why not' basis) so they can make their own assessment of the risks involved.

RG 69.34 The disclosure of a comparative equity ratio from the prior year will help investors identify any change in the issuer's equity capital over the past year.

Benchmark 2: Liquidity

RG 69.35 An issuer should:

(a) have cash flow estimates for the next three months; and

(b) ensure that at all times it has cash or cash equivalents sufficient to meet its projected cash needs over the next three months.

RG 69.36 In reporting against this benchmark, an issuer should disclose:

(a) material assumptions underlying its cash flow estimates (e.g. cash, estimate rollover or retention rates);

(b) how its rollover or retention rate assumptions relate to historical rates; and

(c) its policy on balancing the maturity of its assets and the maturity of its liabilities. For example, where an issuer has a policy of ensuring that its assets and liabilities have similar maturity profiles, it should state this in its prospectus and report against this in its ongoing disclosures.

RG 69.37 An issuer should also disclose whether it would have cash on hand or cash equivalents sufficient to meet its projected cash needs if:

(a) the percentage of note funds to be rolled over during the next three months were 20% less than the percentage that was rolled over in the past three months; or

(b) for note funds that are held on an 'at call' basis—the amount of note funds retained during the next three months were 20% less than the amount that was retained during the past three months.

Note: In estimating cash flows, an issuer can take into account a reasonable estimate of 'rollovers' based on previous experience, but not new fundraising. An issuer should consider possible redemptions as well (if its policy or practice is to allow redemptions). An issuer can also take into account reasonable estimations of cash inflows generated by operations (e.g. payments of interest, repayments of debt) in preparing its cash flow projection.

Explanation

RG 69.38 Liquidity is the proportion of cash or cash equivalents in a company's assets. It is a powerful indicator of the short-term financial health of a company. For note issuers it is relative liquidity (i.e. short-term assets relative to short-term liabilities) that we are particularly concerned with.

RG 69.39 Experience and expert advice we have received show adequate liquidity is a key feature in the ability of note issuers to meet their obligations to investors. Insufficient liquid assets appear to be a contributing factor in recent failures. Historically, lack of liquid assets has been a contributing factor in the failure of otherwise well-capitalised institutions.

RG 69.40 We envisage an issuer would need to review its forecast cash flows on an ongoing basis to determine whether it continues to meet this benchmark. We would expect an issuer to take into account its historical experience on redemptions and rollovers in estimating its cash flows. We also expect an issuer to disclose material assumptions underlying its cash flows (e.g. historical rollover rate) when disclosing against this benchmark.

RG 69.41 By 'cash' or 'cash equivalents' we mean cash or cash equivalents as defined in Australian Accounting Standard AASB 107 *Cash flow statements*. Generally, this includes highly liquid assets that can be reliably realised for cash within a very short period of time and undrawn amounts under certain bank overdraft facilities.

RG 69.42 We expect an issuer to periodically 'stress test' its liquidity assumptions. For example, we would expect an issuer to consider:

(a) its current prospectus and the possibility of an ASIC stop order disrupting its cash flows;

(b) the possibility of an overdraft or other credit facility on which the issuer is relying being withdrawn; and

(c) the possibility of a significant reduction in the rate of investor rollovers.

We would expect an issuer to take into account the results of its stress testing in its liquidity planning. In some cases, this may mean it needs to increase its cash position: see RG 69.35.

Benchmark 3: Rollovers

RG 69.43 An issuer should clearly disclose its approach to rollovers, including:

(a) what process is followed at the end of the investment term; and

(b) how it informs those rolling over or making further investments of any current prospectus and continuous disclosure announcements.

Explanation

RG 69.44 Some note issuers rely on investors keeping their funds in the investment beyond the end of the initial period. In some cases, the terms of the issue allow this to occur automatically unless the investor makes a positive decision to withdraw their funds. In other cases, it is the investor who makes a positive decision to have their funds reinvested. It is important that investors fully understand the issuer's approach to rollovers through clear disclosure in the prospectus.

Note: Issuers should consider the fairness of the contractual terms applying to rollovers in accordance with Subdiv BA of the ASIC Act.

RG 69.45 Section 708(14) of the Corporations Act provides for an exception from the requirement to provide investors with a prospectus for rollovers and offers to existing investors. We consider that it is potentially misleading not to provide investors with updated information when they are considering whether to roll over their investment or make a further investment in notes.

RG 69.46 The commercial circumstances of the issuer may have changed since the initial investment. To ensure investors are fully informed about the circumstances of the rollover, it is important for them to have the benefit of current disclosure (in either a prospectus or disclosure notice) to help them decide whether to continue with their investment. To avoid possible breaches of the Corporations Act, an issuer should contact investors before each rollover and make the current disclosure document and any relevant ongoing disclosure available to them (e.g. direct them to a website where they can obtain the documents): see RG 69.93–RG 69.101.

Benchmark 4: Debt maturity

RG 69.47 An issuer should disclose:

(a) an analysis of the maturity profile of interest-bearing liabilities (including notes on issue) by term and value; and

(b) the interest rates, or average interest rates, applicable to its debts.

Note: For updating information, see Section D.

Explanation

RG 69.48 Disclosure of debt maturities will assist investors in understanding how the business is funded in terms of the nature, timing and cost of the issuer's debt obligations.

RG 69.49 The disclosure of information about the profile of note terms and loan terms (see Benchmark 5) and key assumptions underpinning the issuer's cash flow projections (see Benchmark 2) are generally matters required to be disclosed by s710(1). In our view, it is information that investors and their professional advisers would reasonably require to make an informed assessment of the offer.

Benchmark 5: Loan portfolio

RG 69.50 An issuer who directly on-lends funds, or indirectly on-lend funds through a related party, should disclose the current nature of its (or the related party's) loan portfolio, including:

(a) how many loans they have and the value of those loans;

(b) an analysis of the maturity profile of interest-bearing assets (including loan portfolio) by term and value;

(c) the interest rates, or average interest rates, applicable to the assets;

(d) by number and value, the loans they have by class of activity and geographic region;

(e) an analysis (number of loans, value of loans, value of principal and/or interest) of those loans more than 30 days past due and renegotiated loans;

Note 1: If the issuer monitors arrears on a monthly basis, then an analysis of receivables a month past due can substitute for an analysis of 30 days past due.

Note 2: See the Key terms for definitions of 'past due' and 'renegotiated loans'.

(f) by number and value, what proportion of the total loan money is lent on a 'secured' basis and what is the nature of the security;

(g) by number and value, what proportion of the total loan money they have lent to their largest borrower and their 10 largest borrowers; and

(h) by number, value and percentage, what loans are subject to legal proceedings.

Note 1: For reasons of privacy or commercial confidence, it may not be appropriate to actually *name* the largest borrowers. The total loan money lent to the 10 largest borrowers can be disclosed as an aggregate amount.

Note 2: The term 'related party' should be interpreted broadly: see the Key terms. See the Key terms also for a definition of 'legal proceeding'.

RG 69.51 Disclosure should also cover the issuer's policy on these issues. For example, where the issuer has a policy of not lending more than (say) 5% of its total loan funds to any one borrower, this should be stated in the disclosure document.

RG 69.52 Disclosure should also contain clear explanations about the issuer's approach to taking security in relation to its lending (e.g. what types of security it takes and in what circumstances).

Explanation

RG 69.53 This benchmark and Benchmark 6 (related party transactions) apply to note issuers who on-lend funds raised through the notes. This includes issuers who lend the funds to related parties only.

RG 69.54 Many issuers of unlisted notes on-lend the funds lent to them by note holders. The primary assets of the issuer are the loans it makes to others. The quality of these loans is a key element in the financial position and performance of the issuer.

RG 69.55 The quality of the issuer's loans is important at an overall loan portfolio level, as well as the individual loan level. A key way lenders manage the quality of an overall loan portfolio is to ensure that it is diversified. Portfolio diversity has a number of elements, including:

(a) the number of loans and the value of those loans;

(b) how many loans are related to a particular class of activity (e.g. residential property, commercial property, leasing, development);

(c) geographic concentration (e.g. are the borrowers concentrated in one geographic region?); and

(d) whether the lender has major exposures to a small number of borrowers (e.g. what proportion of funds are lent to the largest borrower, and to the 10 largest borrowers?).

RG 69.56 The more diversified a loan portfolio is, the lower the risk that an adverse event affecting one borrower or one type of loan will simultaneously affect the majority of borrowers, and therefore put the overall portfolio at risk.

RG 69.57 It is important that an issuer discloses in its prospectus its approach to loan portfolio diversification. At the prospectus stage, an issuer may not be able to set out exactly how funds will be lent, but it should be able to generally explain how funds have been lent so far. Most issuers will have a firm policy of how and when they will lend funds. This should be disclosed as clearly and concretely as possible to help trustees and investors monitor the financial position and performance of the issuer over time.

RG 69.58 It is important that investors understand what proportion of loans is secured, by number and by value. However, this needs to be explained carefully, including by reference to the nature and scale of the security (e.g. its ranking, the value of the assets supporting the security and the financial position of any guarantor).

Note: If any security rights (e.g. mortgages) held by the issuer have been assigned or transferred to third parties, this needs to be disclosed as well.

RG 69.59 It is also important for investors to know what proportion of loans are in default and what the issuer's approach is to such loans. The issuer may be relying heavily on repayment of the loans it has made for it to repay note money. Investors (as the holders of the notes) therefore have a strong interest in knowing the proportion of loans in arrears and what the issuer is doing to address this.

Benchmark 6: Related party transactions

RG 69.60 An issuer who on-lends funds should disclose its approach to related party transactions, including:

(a) how many loans it has made to related parties;

(b) the value of those loans;

(c) the value of the loans as a percentage of total assets; and

(d) the assessment and approval process it follows with related party loans when loans are advanced, varied or extended (e.g. are they subject to the approval of the trustee?).

RG 69.61 The issuer should also disclose any policy it has regarding related party lending (including matters such as interest rates, security and loan-to-valuation ratios).

Note: The term 'related party' should be interpreted broadly: see the Key terms.

Explanation

RG 69.62 Related party loans are less likely to be monitored as robustly as third-party loans, and this can affect valuations, loan-to-valuation ratios and credit assessment processes. Related party loans appear to be a contributing factor in some recent failures.

RG 69.63 It is important that an issuer discloses in its prospectus its approach to related party lending. At the prospectus stage, an issuer may not be able to set out exactly how funds will be lent, but it should be able to generally explain how funds have been lent so far. As discussed under Benchmark 5, we expect that most issuers will have a firm policy of how and when they will lend funds and this should be disclosed to investors.

Benchmark 7: Valuations

RG 69.64 Where the issuer is involved in or (directly or indirectly) lends money for property-related activities, it should take the following approach to obtaining and relying on valuations:

(a) properties (i.e. real estate) should be valued on an 'as is' and, for development property, on an 'as if complete' basis;

Note: See the Key terms for definitions of 'as is' and 'as if complete' valuations.

(b) development properties should be re-valued at least every 12 months unless the funds are retained by the issuer and only released in stages to cover project completion costs;

Note: For advancing funds in stages for loans relating to property development, see RG 69.71 and RG 69.75.

(c) an issuer should have a clear policy on how often it obtains valuations, including how recent a valuation has to be when it makes a new loan;

(d) an issuer should establish a panel of valuers and ensure that no single valuer conducts more than one-third of the total number of valuations obtained; and

(e) the appointment of valuers should be with the trustee's consent.

RG 69.65 An issuer should also include information about the valuation of a particular property in its prospectus where:

(a) the property accounts for 5% or more of the total value of property assets of the issuer;

(b) the property accounts for 5% or more of the total value of property assets of a related party through which the issuer has indirectly on-lent money;

(c) a loan secured against the property accounts for 5% or more of the total value of the issuer's loan book; or

(d) a loan secured against the property accounts for 5% or more of the total value of the loan book of a related party through which the issuer has indirectly on-lent money.

Note 1: We would also expect an issuer to include the 'cost' of such a property in the prospectus for comparison purposes.

Note 2: The information about the valuation of a particular property should help the potential investor assess the quality and reliability of the valuation (e.g. the identity of the valuer, the valuation method and the key assumptions).

Explanation

RG 69.66 This benchmark *only* applies to an issuer who is (directly or indirectly) involved in or on-lend funds for property-related activities. It includes an issuer who, for example:

(a) is in the business of property development or lends funds to property developers;

(b) uses funds as part of an 'integrated property' business; or

(c) is involved in mortgage financing.

Note: 'Integrated property' is defined in Consultation Paper 89 *Unlisted, unrated debentures: Improving disclosure for retail investors* (CP 89). See also RG 69.21(c).

RG 69.67 Robust and objective valuations are needed to ensure the issuer's financial position is correctly stated in the prospectus and ongoing disclosure. Valuations affect the key ratios of the issuer—such as the adequate capital, liquidity and loan-to-valuation policies.

RG 69.68 It is therefore important for investor confidence that independent experts perform the valuations, and that the process is transparent. We expect that an issuer's policy should aim to ensure that the valuer is independent from the issuer and its associates. In particular, an issuer should aim to ensure that valuers do not have any conflict of interest that a reasonable person, with full knowledge of all relevant facts and circumstances, would conclude is capable of affecting the valuation.

Note: See Section F for further discussion of valuers and the valuation process.

RG 69.69 It is in the interests of an issuer that the valuations it obtains and uses are robust and accurate. An issuer is responsible for the accuracy of the financial statements and other documents that rely on these valuations. Therefore, we expect that an issuer will only use professional valuers who are registered or licensed in the relevant state or territory, and who are a member of an appropriate professional body and subscribe to that body's standards and code of conduct. We also expect that an issuer will be careful to ensure that its written instructions to valuers are comprehensive and contain reasonable assumptions.

Benchmark 8: Lending principles—Loan-to-valuation ratios

RG 69.70 Where an issuer (directly or indirectly) on-lends money in relation to property-related activities, it should maintain the following loan-to-valuation ratios:

(a) where the loan relates to property development—70% on the basis of the latest complying valuation; and

(b) in all other cases—80% on the basis of the latest complying valuation.

Note 1: For the purposes of calculating the loan-to-valuation ratio, the issuer's loan amount should be added to any prior ranking security and divided by the value of the property security.

Note 2: See the Key terms for the definition of 'complying valuation'.

RG 69.71 Where the loan relates to property development by a second person (even if related to the issuer), the issuer should ensure that funds raised by the issue of notes are only provided to the developer in stages, based on external evidence of the progress of the development.

Explanation

RG 69.72 This benchmark *only* applies to an issuer who (directly or indirectly) on-lends funds for property-related activities. It includes an issuer who, for example:

(a) lends funds to property developers; or

(b) is involved in mortgage financing.

RG 69.73 An issuer's approach to loan-to-valuation ratios is one indicator of how conservative or aggressive its lending practices are. Less conservative lenders are willing to lend funds equal to a higher proportion of a property's value (sometimes up to or exceeding 100% of its value). Such ratios mean that the lender is more vulnerable to the risk that a change in market conditions (such as a downturn in the property market) will lead to it being unable to fully recover the money it has lent to borrowers. It also increases the risk that the security (if any) it has obtained from borrowers will not be sufficient to cover the loan.

RG 69.74 We have separated loans relating to property development from other property-related loans (e.g. residential mortgages). By property development, we mean loans whose main or primary purpose is for real estate developments (e.g. home units, retail, commercial, sub-divisions and industrial development).

RG 69.75 Where funds are on-lent for property development activities, a loan-to-valuation ratio may be agreed up-front, but it is generally not appropriate to advance all of the funds to the developer up-front. Rather, we expect an issuer to put systems and controls in place to ensure funds are only provided to the developer where there is satisfactory progress of the development (based on reliable external evidence of that progress). We also expect that the issuer's policy on how and when funds are provided to developers will be stated in its prospectus.

D Form and method of disclosure

Key points

An issuer of unlisted notes has an obligation to provide disclosure at the time of offering notes, while the offer remains open and while the notes remain on issue: see RG 69.76–RG 69.77.

In meeting these disclosure obligations to investors, an issuer should disclose against the benchmarks in Section C on an 'if not, why not' basis: see RG 69.78–RG 69.81.

Disclosure against the benchmarks should be:

- addressed up-front in the prospectus (see RG 69.86–RG 69.90);
- updated in ongoing disclosure (see RG 69.91–RG 69.101) as material changes occur—for example:
  - in a replacement prospectus, supplementary prospectus or continuous disclosure notice; and
  - at least twice a year, in quarterly reports to trustees; and
- supported in advertising material (see RG 156).

Disclosure obligations

RG 69.76 An issuer of unlisted notes has an obligation to provide disclosure at the time of offering notes, while the offer remains open and while the notes remain on issue. We have issued the following general guidance about these disclosure obligations:

(a) Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228) provides guidance to persons offering securities about how to prepare prospectuses that satisfy the content requirements in s710. It also provides guidance on how to word and present prospectuses in a 'clear, concise and effective' manner under the Corporations Act.

(b) Regulatory Guide 198 *Unlisted disclosing entities: Continuous disclosure obligations* (RG 198) provides guidance for unlisted disclosing entities about how to comply with their continuous disclosure obligations.

RG 69.77 An issuer of unlisted notes should have regard to this general guidance as well as comply with the specific disclosure guidance set out in this section.

Disclosure against the benchmarks: 'If not, why not'

RG 69.78 An issuer should disclose whether it meets the benchmarks in Section C, and if not, why not. 'Why not' means explaining how it deals with the business factor or the issue underlying the benchmark (including the alternative systems and controls the issuer has in place to deal with the issue underlying the benchmark).

Note: Where a benchmark contains multiple requirements, if an issuer cannot meet all the requirements under a benchmark, it should state that it does not meet the benchmark and clearly explain why it failed to meet the particular requirements.

RG 69.79 An issuer's disclosures for Benchmarks 1, 2, 5, 6, 7 and 8 should also explain the importance of each of these benchmarks to its business. We are not prescribing 'boilerplate' or standardised wording—however, we expect an issuer to closely base its disclosure on the material in Table 4, which is adapted from our investor guide, *Investing in unlisted debentures and unsecured notes?*

Table 4: Explanation of benchmarks

Benchmark	Explanation
Benchmark 1—Equity ratio	If the issuer has less equity capital invested in the business, there might be no safety margin to tide things over if the business runs into financial difficulties. It could also mean that the issuer has less incentive to operate the business prudently and responsibly because less of its own money is at risk.
Benchmark 2—Liquidity	Liquidity is an important measure of the short-term financial health of an issuer or business. If the issuer has insufficient cash or liquid assets, it might be unable to meet its short-term obligations (e.g. to run the business properly, pay interest, or pay investors their money back at the end of the term).
Benchmark 5—Loan portfolio	Is the issuer's loan portfolio heavily concentrated into a small number of loans, or loans to a small number of borrowers? If so, there is a higher risk that a single negative event affecting one loan will put the overall portfolio (and investors' money) at risk.
Benchmark 6—Related party transactions	The risk with related party transactions is that they might not be made with the same rigour and independence as transactions made on an arm's-length commercial basis. There is a greater risk of the loans defaulting and, therefore, investors' money is at greater risk if: • the issuer has a high number of loans to related parties; and • the assessment and approval process for these loans is not independent.
Benchmark 7—Valuation	If the issuer does not include information about valuations in the prospectus, it will be more difficult for investors to assess how risky the investment is. Keeping valuations up-to-date and shared among a panel means they are more likely to be accurate and independent.
Benchmark 8—Lending principles	A high loan-to-valuation ratio means that the investment is more vulnerable to changing market conditions, such as a downturn in the property market. Therefore, the risk of investors losing their money could be higher.

RG 69.80 Disclosure against the benchmarks is not intended to lead to longer and more complex disclosure documents. Rather, we expect that this disclosure will help issuers produce disclosure documents that are more focused on the issues that matter to investors and are more clear, concise and effective.

RG 69.81 This approach is based on our view that the inherent risks for investors in unlisted notes mean that information about these risks is:

(a) information that investors and their professional advisers reasonably require to make an informed investment decision (s710(1));

(b) not something investors may reasonably be expected to know without explicit disclosure in a prospectus (s710(2));

(c) needed to ensure a note issuer's quarterly reports to the trustee and to ASIC comply with the content requirements for those reports (s283BF(4)); and

(d) relevant to consideration of whether the issuer is required to issue a supplementary or replacement prospectus (s719) or has obligations under the continuous disclosure provisions (s675).

Note: We have produced an investor guide, *Investing in unlisted debentures and unsecured notes?*, to help investors understand and use the benchmarks and to promote informed decision making. We encourage an issuer to make the guide available to investors—for example, when distributing its prospectus. Copies of the investor guide are available at www.moneysmart.gov.au.

Disclosure in a prospectus

RG 69.82 A prospectus for unlisted notes should contain a clear and prominent disclosure of the key features of the product and its risks. It should address the benchmarks in Section C on an 'if not, why not' basis. This means that it should state that the issuer and product either:

(a) meet the benchmark (including how they meet the benchmark, where appropriate); or

(b) do not meet the benchmark *and* explain how and why the issuer deals with the business factor or the issue underlying the benchmark in another way.

RG 69.83 In addition, we consider that a prospectus should state that the issuer will continue to meet the benchmarks and, if not, why not. In circumstances where a benchmark is not met, the extent of and reasons should be disclosed. In some circumstances, not meeting a benchmark is a risk that should be disclosed prominently.

RG 69.84 An investment overview should be included to help retail investors make an informed decision by highlighting key information. The investment overview should:

(a) be the first substantive section of the prospectus;

(b) highlight and provide a meaningful summary of information that is key to a retail investor's investment decision, including the benchmark information; and

(c) provide balanced disclosure of the benefits and risks.

In particular, we expect an issuer to make it completely clear that the notes are not and should not be confused with bank deposit products.

RG 69.85 We expect an issuer's prospectus for unlisted notes to address in a clear, concise and effective manner:

(a) the business model of the issuer and what it will actually do with the money raised;

(b) the financial position and performance of the issuer;

(c) the risks associated with the investments;

(d) the track record and experience of directors and key management; and

(e) the nature of the note (e.g. what security exists, if any, and whether the issuer is prudentially regulated).

We expect any audit qualification applying to an issuer's financial report to be disclosed and explained in a prospectus.

The role of up-front disclosure

RG 69.86 The law requires up-front disclosure for these products through the mechanism of a prospectus. If you are an issuer preparing a prospectus, you must:

(a) include all information that investors and their professional advisers would reasonably require to make an informed assessment of the issuer and the securities being offered (s710);

(b) make specific disclosures (s711); and

(c) word and present the prospectus in a clear, concise and effective manner (s715A).

RG 69.87 The general prospectus content requirement in s710 is designed to:

(a) promote efficiency in the capital markets;

(b) promote disclosure of relevant information;

(c) reduce the likelihood of omitting important information;

(d) focus issuers on the information needs of investors; and

(e) be sufficiently flexible to accommodate changes in investors' information needs.

In particular, a prospectus should allow the investor to assess the financial position, performance and prospects of the issuer.

RG 69.88 The benchmarks relate to matters that, in any event, must be disclosed under s710. Issues relating to the amount of capital, liquidity, loan ratios, valuations, related party loans and diversification are all matters that investors and their professional advisers would reasonably require to make an informed assessment of the assets and liabilities, financial position and performance, profits and losses, and prospects of the issuer.

RG 69.89 We will consider exercising our stop order powers under s739 if we consider there is material non-disclosure of these matters. Where disclosure against the benchmarks is scattered throughout the document, it is more likely that the document is not clear, concise and effective. We believe that disclosure against the benchmarks up-front in a prospectus is an effective form of disclosure and promotes compliance with the requirement that prospectuses should be worded in a clear, concise and effective manner by:

(a) encouraging comparability and uniformity of financial measures; and

(b) highlighting issues that we and industry experts consider crucial to making an investment decision.

RG 69.90 Experience suggests that clear, concise and effective prospectus disclosure requires simple and clear disclosure of the business model of the issuer and the key risks associated with the issue. We encourage issuers to use communication tools as much as possible in disclosing key features and risks, including using tables, diagrams and other comparative features: see Section B of RG 228.

Ongoing disclosure

RG 69.91 Where there have been any material changes to an issuer's performance against the benchmarks, including against the issuer's alternative approach to meeting the benchmarks, the issuer should explain this in:

(a) a supplementary prospectus;

(b) a replacement prospectus; or

(c) a continuous disclosure notice.

RG 69.92 In addition, an issuer's quarterly reports should, at least twice a year, *specifically* explain any material changes to the issuer's performance against the benchmarks, including against the issuer's alternative approach to meeting the benchmarks.

The role of ongoing disclosure

RG 69.93 Good ongoing disclosure plays an important role in helping investors monitor their investment, evaluate its performance and decide if and when to exit the product. An issuer makes a number of statements in the prospectus about how the funds being raised will be used, and how the issuer will conduct its business. These ‘promises’ are part of the basis on which the investor invests their money, and the investor should be given the opportunity to monitor the issuer’s performance against these promises.

Example: Investment decision and ongoing disclosure

Ms Investor has $20,000 invested in notes issued by Issuer 123 Ltd due for repayment in the next three months. 123 Ltd has ceased raising funds from new investors at this time, and so has no current prospectus. 123 Ltd writes to Ms Investor asking if she would like to roll over her investment for a further three years and provides Ms Investor with a copy of its latest quarterly report, a subsequent continuous disclosure notice and information about where later continuous disclosure notices may be found on its website.

Ms Investor sees from the material provided that 123 Ltd, through enforcing security against some of its borrowers, is now engaged in the development of property itself, rather than simply providing finance to others. Ms Investor is not confident that 123 Ltd will be profitable as a property developer, and so she decides not to roll over her investment.

RG 69.94 An issuer has a number of ongoing disclosure obligations that help investors and the trustee monitor performance. These include:

(a) issuing a supplementary or replacement prospectus (as needed);

(b) quarterly reports to the trustee, which are also lodged with us (s283BF(4));

(c) audited annual and half-yearly financial reports (Ch 2M); and

(d) continuous disclosure of material information not otherwise covered by a new prospectus or supplementary prospectus (s675).

Note: For further information on the continuous disclosure obligations of unlisted disclosing entities, see RG 198.

Supplementary or replacement prospectus

RG 69.95 Where there is a current prospectus, s719 requires an issuer to lodge a supplementary or replacement prospectus where, among other matters, there is a misleading or deceptive statement in the prospectus or where there is an omission of information required under s710.

RG 69.96 If the issuer becomes aware of information that is not generally available and that a reasonable person would expect, if it were available, to have a material effect on the price or value of the securities of the entity, s675 requires the issuer to lodge a document with us containing the information. However, where there is a prospectus on issue, s675 does not require lodgement of a document with us if the information is required to be included in a supplementary or replacement prospectus.

RG 69.97 Supplementary and replacement prospectuses must be given to prospective investors: s719(4), 719(5) and 704. Note holders can ask for the financial reports of an issuer free of charge: s318.

Quarterly reports

RG 69.98 Quarterly reports must include details of:

(a) money deposited with or lent to a related body corporate (s283BF(5)), including:

  (i) the total of the money deposited with or lent to the related body corporate; and

  (ii) the total amount of money owing to the issuer at the end of the quarter in respect of the deposits or loans to the related body corporate;

(b) details of any liability of a related body corporate that the issuer has assumed during the quarter, including the extent of the liability at the end of the quarter (s283BF(6));

(c) any failure of the issuer to comply with the terms of the notes;

(d) any circumstances that have occurred during the quarter that materially prejudice the issuer;

(e) any substantial change in the nature of the business of the issuer that has occurred during the quarter; and

(f) any other matters that may materially prejudice any security or the interests of the note holders: s283BF(4).

Note: See also RG 69.139 and [CO 12/1482].

RG 69.99 Quarterly reports are designed to give the trustee (and ASIC) regular updates about the performance of the issuer. The benchmarks in Section C are the key features and risks for these products so, in our view, diversions from the benchmarks are material issues that should be covered in quarterly reports. For example, if the issuer stopped meeting the minimum capital or liquidity benchmark during the quarter, this would clearly be a matter that materially prejudices the interests of the note holders and that should be brought to the trustee's attention.

Making ongoing disclosure available

RG 69.100 Ongoing disclosure documents (including those lodged with us) should be made available to all note holders (e.g. by an issuer putting them on its website). We believe this will encourage greater scrutiny of the ongoing operations of the issuer, and help trustees and investors in monitoring the financial position and performance of the issuer.

RG 69.101 We will not require an issuer to lodge information with ASIC to satisfy its continuous disclosure obligation if the information is provided on the issuer's website in accordance with our best practice guidelines: see RG 198.12–RG 198.13. Investors can access quarterly reports from ASIC free of charge.

E Trustees of issues

Key points

We expect the trustees of issues of unlisted notes to support the guiding principles in Table 1 in Section A.

In particular, we expect trustees to actively monitor the financial position and performance of the issuer, and to take into account an issuer's performance against the benchmarks in fulfilling their obligations under the legislation.

The trustee's role

RG 69.102 The law requires that when notes are offered and a prospectus is required, the issuer must also appoint a trustee. The trustee's duty under the trust deed and the Corporations Act is to 'exercise reasonable diligence' in monitoring the issuer's ability to repay the notes (e.g. its financial position and performance). In some circumstances, it may need to notify us, seek appropriate court orders or call a meeting of investors to fulfil its duties.

RG 69.103 An issuer should set out in its prospectus whether it meets the benchmarks in Section C and, if not, what alternative approach it takes to managing the issues underlying those benchmarks. In our view, the matters referred to in these benchmarks are key to an issuer's ability to meet its obligations to investors, and particularly its obligations to repay principal sums invested by note holders at the time set out in the terms of the note.

RG 69.104 In that sense, what an issuer says in its prospectus about the benchmarks is relevant to a trustee's obligation to monitor whether the issuer will be in a position to repay amounts lent by note holders.

RG 69.105 We therefore consider that trustees should take into account an issuer's performance against the benchmarks in fulfilling their obligations under the legislation.

Monitoring disclosure against the benchmarks

RG 69.106 If an issuer discloses in a prospectus that it meets each of the benchmarks, continuing performance against them is directly relevant to the issuer's ongoing ability to meet its repayment obligations. If an issuer ceases to meet a benchmark, in our view, a reasonably diligent trustee should carry out sufficient inquiries to satisfy itself that the ability of the issuer to meet its obligations has not been materially impaired.

RG 69.107 Similarly, if an issuer's prospectus discloses that an issuer does not meet one or more of the benchmarks, a trustee should use the 'why not' part of that disclosure to understand enough about the way the issuer is operating its business to use that understanding to monitor the issuer's ongoing ability to meet its obligations to investors.

RG 69.108 An issuer should also be reporting against the benchmarks in its ongoing disclosure. This is one of the reasons why, at least twice a year, an issuer should include in its quarterly report to the trustee information about its performance against the benchmarks, as discussed in its prospectus: see RG 69.98–RG 69.99. We expect trustees to scrutinise these reports and to use them to monitor the financial performance of the issuer because it is critical to the issuer's ability to repay the note holders.

RG 69.109 We expect trustees to:

(a) actively monitor the financial position and performance of the issuer, including using the benchmarks and other information set out in the quarterly reports, and half-yearly and annual financial reports; and

(b) assess and form a view (and record this in writing) about the financial position and performance of the issuer at regular intervals (e.g. at least quarterly).

RG 69.110 We do not expect trustees to form a view about whether the issuer's disclosure documents comply with the law, but we do expect trustees to use the information in those disclosures to monitor the financial position and performance of the issuer.

RG 69.111 If a trustee forms the view that an issuer is failing to meet the promises made in its disclosure documents, or that there have been material adverse changes in the financial position or performance of the issuer, the trustee should notify both ASIC and the investors promptly. For serious matters, we would expect the trustee to seek appropriate court orders or call a meeting of investors and seek their instructions about what action to take. We note that the aim of the statutory provisions in Ch 2L of the Corporations Act are to ensure that trustees may be active in the protection of investors.

Underlying principles

RG 69.112 The law requires a trustee to be appointed to help protect the interests of investors and to facilitate the ongoing monitoring of the issuer. An issuer is obliged to report regularly to the trustee, including:

(a) quarterly reports (s283BF);

(b) information about security interests (s283BE); and

(c) half-yearly and annual financial reports (Ch 2M).

RG 69.113 The trustee has the power to call meetings of the investors and provide information to and make recommendations to the investors: s283EB. This is an important protective measure because the trustee has greater resources and experience than retail investors, and is therefore more likely to identify issues with the financial position and performance of the issuer.

RG 69.114 The trustee's statutory duty is to exercise reasonable diligence to ascertain:

(a) whether the property of the issuer will be sufficient to repay the amounts lent; and

(b) whether the issuer has committed a breach of the terms of the notes, the trust deed or Ch 2L of the Corporations Act. This includes the issuer's general obligations to carry on its business in a 'proper and efficient manner': see s283DA.

RG 69.115 In our view, monitoring the financial position and performance of the issuer generally, and the issuer's performance against its disclosures against the benchmarks in its prospectus, is part of exercising this reasonable diligence.

RG 69.116 A trustee's duties are a combination of general law duties and duties set out in the Corporations Act. We expect trustees to take their duties into account when negotiating the terms of trust deeds with issuers. To ensure that they are in a position to carry out their duties under the Corporations Act, trustees may need to negotiate additional terms or powers (e.g. the power to appoint an independent expert or the inclusion of some of the matters referred to in the benchmarks into their trust deed).

RG 69.117 We consider that a lack of power for a trustee to intervene because of defects in the trust deed is an unacceptable reason for a trustee's failure to properly carry out its obligations under the Corporations Act. If a person is asked to take on a trustee role in circumstances where the proposed trust deed does not provide them with sufficient powers to ascertain whether an issuer will be able to meet its obligations to investors, the trustee may need to decline to act as trustee for that issuer.

F Auditors and valuers

Key points

We expect other parties involved with the issue of unlisted notes to support the guiding principles in Table 1 in Section A—in particular:

- auditors (see RG 69.118–RG 69.122); and
- valuers (see RG 69.123–RG 69.124).

Auditors

RG 69.118 An issuer must lodge half-yearly and annual financial reports. Annual reports must be audited, and half-yearly reports must at least be reviewed by an auditor. These reports help trustees and investors monitor the financial position and performance of the issuer.

RG 69.119 When auditing the annual financial report of the issuer, we expect an issuer to engage its auditors to prepare a separate report on the benchmarks.

RG 69.120 The auditor's report on the benchmarks should have regard to information available in:

(a) the quarterly report most recently submitted by the issuer to the trustee;

(b) recent continuous disclosure notices lodged during the financial year;

(c) the most recent prospectus; and

(d) any supplementary prospectus.

RG 69.121 The auditor's report should be produced at the same time as the financial report and attached to the financial report lodged with us. Copies of the auditor's report should be provided to any users of the financial report.

> Note: We have made a pro forma 'auditor's benchmark report' available that can be used to meet this requirement: see Pro Forma 223 *Interim auditor's benchmark report* (PF 223).

RG 69.122 Auditors of note issuers have some additional obligations, designed to focus their attention on matters that the auditor becomes aware of during the audit. They are obliged to notify the trustee within seven days of any matter that in the auditor's opinion 'is or is likely to be prejudicial to the interests of note holders': s313.

Valuers

RG 69.123 A key aspect of the quality of the issuer’s loan assets is their valuation. We expect valuers who accept an appointment to provide valuations for a note issuer to:

(a) where possible, be registered under one of the state/territory valuer registration regimes; and

(b) include a warranty in their valuation reports that:

  (i) the report complies with all relevant industry standards and codes; and

  (ii) the valuer has prepared the valuation independently and is not aware of any conflict of interest that a reasonable person would conclude is capable of affecting the valuation.

RG 69.124 Robust and objective valuations are necessary to ensure that the issuer’s financial position is correctly stated in the prospectus and ongoing disclosures. It is important that valuers involved with note issuers are regulated under the relevant state/territory regime and that these valuations comply with the relevant industry codes. However, we realise that not all states and territories have a registration or licensing regime at this time.

G Naming of debentures

Key points

Section 283BH of the Corporations Act sets out rules on how debentures can be described.

We have modified the Corporations Act to introduce a further category, called 'secured notes', which issuers can use to describe their debentures. This category or name is available if certain conditions are met, including where the property offered as security is sufficient and reasonably likely to be sufficient to repay investors: see Class Order [CO 12/1482] *When debentures can be called secured notes*.

The 'secured notes' description does not mean the product is safe, and investors will still need to consider the prospectus, including the adequacy of the property offered as security. We will shortly update our investor guide, *Investing in unlisted debentures and unsecured notes?*, to reflect the introduction of the 'secured notes' category.

We had an interim no-action position in relation to the naming of debentures in a prospectus and related documents. The no-action position will end on 1 April 2012 so that issuers will need to fully comply with s283BH in documents relating to an offer of notes made under a disclosure document lodged with ASIC after 1 April 2012.

The categories of debentures

RG 69.125 Section 283BH of the Corporations Act (including as modified under [CO 12/1482]) sets out specific rules on how debentures can be described. The categories of debentures under s283BH are:

(a) mortgage debentures;

(b) debentures;

(c) secured notes; and

(d) unsecured notes or unsecured deposit notes (these two terms are interchangeable under the Corporations Act).

RG 69.126 Whether an issuer may use one of these names depends on the type of property offered as security (if any) and, if offered, whether it is sufficient and reasonably likely to be sufficient to repay the money owed. Certain other conditions must also be met if the offer uses the 'secured notes' description. Each of the categories is discussed below.

‘Mortgage debentures’ and ‘debentures’

RG 69.127 An issuer may describe or refer to its product as a ‘mortgage debenture’ only if the debenture trustee has been given a registered first mortgage over land vested in the issuer and the total amount secured by the mortgage does not exceed 60% of the value of the issuer’s interest in the land.

RG 69.128 An issuer can describe or refer to its product as a ‘debenture’ in documents relating to an offer if the repayment of debenture money has been secured by a security interest in favour of a debenture trustee over tangible property of the issuer and the value of the tangible property that makes up the security for the security interest is sufficient to repay the debentures and any other liabilities of the issuer that rank in priority or have equal priority to the debentures.

RG 69.129 An issuer may also choose to describe or refer to its product as a debenture if it satisfies the definition of mortgage debenture.

RG 69.130 A key determinant of whether a product may be called a ‘debenture’ is whether the obligation to repay the principal is secured by a security interest over ‘tangible property’.

RG 69.131 We consider that ‘tangible property’ is property that has an actual physical existence—for example, goods and land. Tangible property is distinguished from intangible or incorporeal property such as choses in action (e.g. a receivable). We consider that a security interest in favour of a trustee over a loan receivable by an issuer, even if the issuer’s loan receivables are secured by a mortgage over land, does not constitute a security interest over the ‘tangible property’ of the issuer. As a result, this type of investment cannot be called a debenture for the purposes of s283BH.

‘Secured notes’

RG 69.132 An issuer can only describe or refer to its product as a ‘secured note’ in documents relating to an offer if:

(a) the repayment of investor money has been secured by a first ranking security interest (i.e. the highest priority security interest) in favour of a debenture trustee over property of the issuer or guarantor, and the value of the property that makes up the security for the security interest is sufficient to repay the secured notes and any other liabilities of the issuer that rank in priority or have equal priority to the secured notes;

Note 1: The secured property taken into account in this case is not limited to tangible property.

Note 2: Although the security interest must be first ranking, other liabilities may have priority under statute (e.g. due to the operation of s556).

(b) the issuer provides an explanation of the security (including a confirmation of the sufficiency of the assets supporting the security) in any quarterly report prepared under s283BF or disclosure documents relating to the offer;

(c) the issuer provides details of whether the value of any property secured by the security interest may be affected by the financial position or performance of a related body corporate or related party of the issuer in any quarterly report prepared under s283BF or disclosure documents relating to the offer;

(d) the issuer includes on its website its latest quarterly report prepared under s283BF, any current prospectus, supplementary or replacement prospectus, and any continuous disclosure notice produced within the last year; and

(e) the issuer includes in advertisements relating to an offer of secured notes the statements that: 'this product is not a bank deposit' and 'there is a risk that you could lose some or all of your money'.

RG 69.133 These conditions are imposed under s283BH, as modified by [CO 12/1482], and are discussed in more detail in RG 69.135–RG 69.140.

Note: An issuer who is entitled to refer to its product as a 'mortgage debenture' or 'debenture' under s283BH is also permitted to refer to its product as a 'secured note' provided the requirements of [CO 12/1482] are met.

'Unsecured notes' or 'unsecured deposit notes'

RG 69.134 When a product does not meet the standards to be called a 'debenture' or 'secured note' for the purposes of s283BH (including as modified by [CO 12/1482]), the product must be described as an 'unsecured note' or 'unsecured deposit note' for the purposes of s283BH. These two terms are interchangeable under the Corporations Act.

Conditions to the use of the term 'secured note'

RG 69.135 RG 69.132 sets out the conditions that must be observed by issuers seeking to call their products 'secured notes'.

Sufficiency of property as security

RG 69.136 A key condition for the use of the 'secured note' description relates to whether the property that constitutes the security for the first ranking security interest is sufficient and is reasonably likely to be sufficient to meet the liability for the repayment of investors' money and any other liabilities of the issuer that rank in priority or have equal priority to the secured notes. The concept of sufficiency of property is discussed at RG 69.141–RG 69.144.

Description of the property and security

RG 69.137 In describing the property and security in disclosure documents or quarterly reports prepared under s283BF, an issuer should provide a general description of the nature of the security and assets covered by the security interest with sufficient detail to enable readers to understand the business model. For example:

> '... are secured by first ranking security interests (including...) in favour of the Trustee over the Company's assets, predominantly comprising loan receivables and also real property. Details of these assets are provided in Benchmark 5 (including information relating to past due loans and impairment) and the investment overview section of the prospectus. Further information concerning the Company's lending activities is provided in Benchmarks 6 to 8 in Section 3 of the Prospectus.'

Details of related party exposure

RG 69.138 It is relevant for investors to understand if the value of assets secured by a security interest may be affected by the financial position or performance of a related party or related body corporate. This will allow investors to assess whether there is any risk that any related party transactions have not been entered into, or monitored, with the same rigour and independence as transactions made on an arm's-length commercial basis. Investors will be able to consider such exposure by reviewing information disclosed in a prospectus in accordance with Benchmark 6.

Ongoing disclosure

RG 69.139 If the term 'secured note' is used, updated information about the property and security which gives investors information about the sufficiency of the security must be included in disclosure documents and quarterly reports prepared under s283BF. Making this information readily available to investors by providing it on the issuer's website is an important way investors may gain an understanding of the nature and adequacy of the security for notes described as 'secured notes'. In addition, any continuous disclosure notices required to be lodged with ASIC in the previous 12 months will also assist investors.

Statements in advertising

RG 69.140 Issuers must ensure that the statements to be included in advertisements relating to an offer are prominent, as discussed in RG 156. We consider this is important because even when a product can be described as a secured note, this does not mean that the product is safe or without risk. Therefore, statements required by [CO 12/1482] that are buried in the fine print of an advertisement will not be regarded as sufficiently prominent.

The concept of 'sufficiency of property'

RG 69.141 The term 'debenture' or 'secured note' may be used only if the property that is provided as security is sufficient and is reasonably likely to be sufficient to meet the liability for the repayment of money lent under the notes and other liabilities ranking in priority or equally to that liability. In the case of the term 'debenture', only tangible property can be counted. The sufficiency concept aims to ensure that the trustee has security over sufficient assets so that holders of debentures and secured notes can be confident that all or a high proportion of the funds owing to them will be repaid.

RG 69.142 The extent by which the value of the property over which security is held exceeds the quantum of money that has been or may be lent under the notes is a key consideration in determining the sufficiency of the property provided as security. In view of the policy underlying the requirement that there be sufficient property, care needs to be taken to ensure that a practical approach is taken to asset values, and it cannot be assumed that a best case outcome will occur. For example, an issuer should consider:

(a) the nature and condition of the relevant assets, particularly whether there has been any asset impairment (e.g. in the case of security over loan receivables, the extent to which the loans are in arrears);

(b) the age of any valuations and whether anything has occurred that casts doubt on the accuracy of the valuation (e.g. delays in any applicable development process); and

(c) the extent to which the assets reflect transactions made with related parties.

RG 69.143 If an issuer intends to count intangible property in judging whether it is entitled to call notes issued by it 'secured notes', we consider that the intangible assets should be individually identifiable and considered as separable intangibles under the Australian accounting standards. Issuers should avoid ascribing too much value to intangible assets that may be difficult to realise (e.g. intellectual property).

RG 69.144 Also relevant in considering whether there is sufficient property are:

(a) the capital base and surplus funds of the issuer (e.g. as discussed in the equity capital and liquidity benchmarks, including whether there is a sufficient 'buffer' of shareholders' funds or liquid reserves to meet future obligations); and

(b) the amount of likely liabilities that rank in priority or equally with the liability for the repayment of money lent under the notes (e.g. any statutory priorities on a winding-up), together with the assets that are likely to be available to meet these liabilities.

Example: Secured notes

Issuer XYZ Ltd operates a mortgage financing business and funds its business by raising money from investors under a prospectus and using it to on-lend to third parties. XYZ Ltd has a diverse loan book with a minimal amount of arrears and one impaired loan totalling 0.25% of its loan book. XYZ Ltd actively manages its loan book and takes appropriate action where borrowers are not meeting their obligations. XYZ Ltd advances funds to borrowers secured by a registered first mortgage and to no greater than a 70% loan-to-valuation ratio. XYZ Ltd has an equity ratio of 8% and the trustee has a first ranking security interest over all of the assets of XYZ Ltd, which are considerably in excess of the amount it is liable to repay to investors.

All of XYZ Ltd's assets would be available to investors if the security was enforced (subject to statutory priorities). XYZ Ltd's directors have confirmed in the prospectus that the property offered as security is sufficient and reasonably likely to be sufficient to repay investors. They describe the product as a 'secured note' for the purposes of s283BH and include the risk statements in their advertisements.

Example: Unsecured notes or unsecured deposit notes

Like XYZ Ltd, issuer ABC Ltd also operates a mortgage financing business and funds its business by raising money from investors under a prospectus and using it to on-lend to third parties. ABC Ltd has a low level of equity and carries on a lending business with a loan book that comprises a substantial amount of past due loans, of which 10% have been assessed as impaired. The unpaid principal and interest on a large number of the loans has resulted in the amounts owing being greater than the original loan-to-valuation ratio when the loans were advanced.

If the loan book was to be realised or valued today, ABC Ltd's loan book may only be valued or realised at a significant discount to the face value of loans, together with accrued interest on its past due loans. There is a real possibility that the value of the loan book along with other assets would not be sufficient to repay investors based on an estimate of the market value at the time. ABC Ltd describes the product as 'unsecured notes' in its prospectus.

ASIC's no-action position: Transition period

RG 69.145 In 2005, we announced an interim no-action position in relation to certain non-compliance with the naming restriction under s283BH: see Report 38 *High-yield debentures* (REP 38) at pp. 10–12. The no-action position, in effect, allowed issuers to treat property without an actual physical existence (e.g. receivables) as 'tangible property' for the purposes of s283BH.

RG 69.146 We have decided to discontinue the interim no-action position set out in REP 38 for all documents relating to an offer of notes made under a disclosure document with a lodgement date after 1 April 2012.

Branding of products

RG 69.147 We will not refuse lodgement of a prospectus which, in addition to using the description prescribed in s283BH, also describes the product in another way, provided that:

(a) the description used is not false or misleading—for example, the description of an unsecured note or an unsecured deposit note must not include the terms set out in items 1, 2 or 2A of s283BH(1);

(b) the description does not result in an omission from the prospectus—for example, by being a half-truth; and

(c) the prospectus clearly and prominently characterises the notes using the description prescribed by s283BH—for example, as an unsecured note or an unsecured deposit note.

Note: Issuers should comply with the advertising standards described in RG 156.

Key terms

Term	Meaning in this document
AASB 107 (for example)	An Australian accounting standard made for the purposes of the Corporations Act (in this example, numbered 107)
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
'as if complete' valuation	An estimate of the market value of a property, assuming certain specified improvements are made
'as is' valuation	An estimate of the market value of a property in its current state (i.e. without any further improvements)
Australian accounting standards	Standards made for the purposes of the Corporations Act
Ch 2M (for example)	A chapter of the Corporations Act (in this example, numbered 2M)
complying valuation and complying market valuation	A valuation obtained under Benchmark 7(a) or value ascribed to a property (e.g. capital improved value) in a municipal rates valuation
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
CP 94 (for example)	An ASIC consultation paper (in this example, numbered 94)
legal proceeding	A proceeding in a court to recover a payment due under a loan, or taking possession of property under a mortgage or taking any other action to enforce a mortgage
market value	An estimate of the amount for which the property or asset could exchange on the valuation date between a willing buyer and a willing seller in an arm's-length transaction
past due	For a financial asset, this is when a counterparty has failed to make a payment when contractually due
related party	The term 'related party' should be interpreted broadly, taking into consideration the definitions of 'related party' in s228 and Australian Accounting Standard AASB 124 *Related party disclosures*
renegotiated loans	Loans where principal or interest was otherwise greater than 30 days past due that have been restructured, transferred or whose terms have been renegotiated within the past six months
RG 156 (for example)	An ASIC regulatory guide (in this example, numbered 156)

Term	Meaning in this document
rollover	Where an existing investor keeps their money in the existing note investment for an additional term (whether on the same or slightly different terms)
s710 (for example)	A section of the Corporations Act (in this example, numbered 710)
security interest	Has the meaning given by s51A Note: This includes a charge.
unlisted notes	Notes that are not quoted on a financial market: see RG 69.1–RG 69.3 for information on who this guide applies to

Related information

Headnotes

advertising, auditors, benchmarks, debentures, disclosure, issuers, listed, mortgage debentures, secured notes, prospectus, trustees, unsecured notes, valuers

Regulatory guides

RG 99 *Quotation of securities offered by prospectus (s1031)*

RG 156 *Advertising of debentures and notes to retail investors*

RG 198 *Unlisted disclosing entities: Continuous disclosure obligations*

RG 228 *Prospectuses: Effective disclosure for retail investors*

Legislation

Corporations Act, Chs 2L, 2M and 6D, s313, 318, 283BE, 283BF, 283BH, 283DA, 283EB, 556, 675, 704, 708, 710, 711, 715A, 719, 723 and 739

Class orders

Class Order [CO 12/1482] *When debentures can be called secured notes*

Consultation papers

CP 89 *Unlisted, unrated debentures: Improving disclosure for retail investors*

CP 94 *Debenture advertising*

CP 123 *Debentures: Strengthening the disclosure benchmarks*

CP 151 *Debt securities: Modifying the naming provisions and advertising requirements*

Reports

REP 38 *High-yield debentures*

REP 108 *Report on submissions for CP 89 Unlisted, unrated debentures*

REP 113 *Report on submissions for CP 94 Debenture advertising*

REP 127 *Debentures: Improving disclosure for retail investors*

REP 173 *Debentures: Second review of disclosure to investors*

REP 276 *Response to submissions on CP 151 Debt securities: Modifying the naming provisions and advertising requirements*

Investor guide

Investing in unlisted debentures and unsecured notes?

Pro forma

PF 223 *Interim auditor's benchmark report*

Media and information releases

MR 08-82 *ASIC acts to provide retail investors with better disclosure in unlisted unrated debentures* (23 April 2008)