ASIC
Australian Securities & Investments Commission

CONSULTATION PAPER 199

Debentures: Reform to strengthen regulation

February 2013

About this paper

This consultation paper seeks feedback on reform proposals to strengthen the regulation of companies that issue debentures to retail investors.

For debenture issuers that raise funds from retail investors to on-lend, we are seeking feedback on our proposed capital and liquidity requirements. We are also proposing that these companies should provide a prospectus to existing investors when offering new debentures (including rollovers).

For the retail debenture sector, generally, we propose that the role of trustees and auditors should be enhanced.

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 paper was issued on 13 February 2013 and is based on the Corporations Act as at the date of issue.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

Contents

The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach reform may take and are not necessarily the final position on the proposals.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information.

We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our recommendations on the appropriate reform for the debenture sector. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section F, 'Regulatory and financial impact'.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 28 March 2013 to:

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What will happen next?

Stage 1	13 February 2013	ASIC consultation paper released
Stage 2	28 March 2013	Comments due on the consultation paper
Stage 3	From 2 April 2013	Government, ASIC and APRA confer on feedback received

A Overview

Key points

The Government has asked the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) to consult on a number of proposals intended to strengthen the regulation of companies that issue debentures to retail investors.

APRA will consult on proposals that will help establish a clearer distinction between deposits with authorised deposit-taking institutions (ADIs) and debentures issued by other entities.

In this paper, we are proposing that debenture issuers that raise funds from retail investors and on-lend those funds should comply with mandatory capital and liquidity requirements: Section B. They should also give existing retail investors a prospectus for debenture rollovers as well as other new offers of debentures: Section E.

We are also proposing that, in relation to all debenture issuers:

- the role of trustees under Ch 2L of the *Corporations Act 2001* (Corporations Act) should be clarified, and they should have greater express powers to obtain the information that they need from debenture issuing companies (Section C); and
- auditors should give the audited annual report, reviewed half-yearly report and any s313(2) report directly to the trustee and answer any reasonable questions the trustee may ask (Section D).

The proposed requirements will not be part of a regime involving prudential supervision which involves a continuous high degree of regulator engagement with supervised entities and extensive powers to intervene to minimise business failure.

Background

1 A debenture is a security that represents an undertaking by a company promising an investor to repay money at a future point in time. Debentures are a way for a company to raise funds for its business activities. In return for investors' money, the issuer of the debenture promises to pay interest before or on the return of the investors' money. Debentures can be issued on a secured or an unsecured basis.

2 Regulation of the retail debenture sector has historically been based on disclosure, with companies required to use a prospectus for offers of debentures to new retail investors: Ch 6D of the Corporations Act. These companies, whether they are listed or unlisted, must then keep their investors updated through continuous disclosure: Ch 6CA of the Corporations Act. The Corporations Act also requires companies that offer debentures to retail

investors to have a trustee: s283AA. Under s283AC, debenture trustees are typically a public trustee, an ADI or a licensed trustee company, although certain other categories of trustee are possible. Trustees have an important role in monitoring the financial position of the debenture company and whether it is complying with its obligations. They also have the right on behalf of debenture holders to enforce the debenture company's duty to repay: Ch 2L of the Corporations Act.

3 Accordingly there are currently two key elements in the regulation of debenture issuers: disclosure to potential and existing investors by the debenture issuer and oversight of the issuer's debenture obligations by the debenture trustee.

ASIC's role in the retail debenture sector

4 ASIC has focused on the retail debenture sector over the past several years because there has been a high level of failure in this sector, with the result that retail investors have lost significant amounts of money. This is particularly the case for debenture issuers that raise funds from retail investors to on-lend, and especially where the loans are property related.

5 The focus of much of our work has been on disclosure to retail investors. This is consistent with the disclosure-based regulatory settings applicable to the industry. A brief description of our work in relation to this sector since 2004 is set out in the appendix.

6 In 2007, we introduced 'if not, why not' disclosure benchmarks that were developed after extensive public consultation and collaboration with industry experts. The benchmarks require unlisted debenture issuers to disclose whether their business meets key benchmarks (and if not, why not): see Regulatory Guide 69 *Debentures and notes: Improving disclosure for retail investors* (RG 69). Examples of the benchmarks include capital and liquidity levels, loan portfolios and related party transactions. The aim of the benchmarks is to help ensure that investors can assess the financial health of the issuer and the risks of lending to the issuer through debentures and notes.

7 Since 2007, we have undertaken risk-based surveillance of the unlisted debenture sector, working in conjunction with industry gatekeepers such as debenture trustees. This has included on-site visits to issuers, and meetings with trustees. We have also engaged in various measures to promote investor awareness of the risks associated with investing in debentures. These include releasing public reports on each issuer's compliance with the benchmarks, posting information for investors on our MoneySmart website and through media releases.

8 In October 2012, receivers and managers were appointed to Banksia Securities Ltd, one of the largest and most established debenture issuers.

This failure, together with other failures in the debenture sector, highlighted continuing concerns about the activities of companies that borrow funds from retail investors through the issue of debentures to on-lend. Following the failure of Banksia, ASIC formed an internal taskforce to review the debenture sector: Media Release (12-262MR) *ASIC taskforce to review Banksia and regulation of unlisted debentures* (31 October 2012). As part of this taskforce, we have met with industry bodies, trustees, auditors and other business experts about the future regulation of the debenture sector. We have also spoken with other regulators both in Australia and in other jurisdictions.

9 As a result of our review, we concluded that the existing disclosure-based regime may not ensure that retail investors in debentures are confident and informed, and we identified a number of options going beyond disclosure for improving the financial position of debenture issuers and enhancing supervision of them by trustees.

Reform to strengthen regulation of debenture issuers

10 On 22 December 2012, the Government announced that ASIC and APRA would consult on proposals to strengthen the regulation of finance companies that issue debentures to retail investors.

11 The Government's proposals have two broad aims. One aim is to more clearly differentiate debenture issuers from ADIs (i.e. banks, building societies and credit unions) which are regulated under APRA's prudential framework. Investors need to understand that debenture investments carry higher risks and are not the same as deposits with ADIs. APRA will be separately consulting on proposals in this area.

12 The other aim of the proposals is to improve the oversight and financial strength of debenture issuers, particularly those which issue debentures to retail investors and on-lend those funds. These companies have been an important source of loan finance in some regional areas and there is a need to place the industry on a more sustainable footing and restore investor confidence.

13 We are therefore consulting on the following proposals in this paper:

(a) to require companies who issue debentures to retail investors and on-lend those funds to comply with minimum capital and liquidity requirements (see Section B);

(b) to clarify and extend the role of trustees under Ch 2L of the Corporations Act and give them greater express powers to obtain the information they need from debenture issuers (see Section C);

(c) to require that issuers ensure that twice yearly their auditor reports to the trustee and answers the trustee's reasonable questions (see Section D); and

(d) to require companies who issue debentures to retail investors and on-lend those funds to give existing investors a prospectus for any further investments and rollovers (see Section E).

14 Table 1 sets out the proposed reforms, and the types of entities to which the reforms would be applicable.

Table 1: Outline of our proposed reforms

Proposed reform	Who will the reform apply to?
Minimum capital and liquidity requirements: see Section B.	Companies who issue debentures to retail investors and on-lend those funds: see our definition of 'retail debenture issuing lenders' at proposal B1.
Clarification and extension of the role of trustees: see Section C.	All companies that issue debentures to retail investors, including those issuing retail bonds.
Additional communication between auditors and debenture trustees: see Section D.	All companies that issue debentures to retail investors, including those issuing retail bonds.
Removing the prospectus exemption in s708(14) for rollovers: see Section E.	Companies who issue debentures to retail investors and on-lend those funds: see our definition of 'retail debenture issuing lenders' at proposal B1.

15 We consider that the proposed amendments should apply to both listed and unlisted debenture issuers because the purpose of the proposed amendments is to strengthen the regulation of debenture issuers beyond what can be achieved by a disclosure regime, including the continuous disclosure regime that applies to listed companies. Our primary focus is better regulating companies who borrow money from retail investors through the issue of debentures. This business model is the same whether the company is listed or unlisted.

16 The Corporations Act already recognises that investors in debentures should be subject to particular protections compared to other securities products: see Ch 2L of the Corporations Act. The Government proposals supplement the existing regime. A focus on debenture issuers engaging in lending activities is also consistent with the current international focus on 'shadow banking' activities. For example, a special regime for debentures has been introduced recently in New Zealand following the failure of a number of finance companies in that country.

17 Following consultation, the Government and regulators will make a final decision on any new framework, including appropriate transitional arrangements: Minister for Financial Services and Superannuation, Media

Release No. 093, *Roadmap to a sustainable future for finance companies*, 22 December 2012.

Further consultation

18 This paper discusses the aims of our proposed reforms and describes them at a high level. If the Government decides to proceed with the reforms, following the consultation process, the final detail of the reforms and the drafting of regulations and/or guidance required for their implementation will need to be settled. At that time, we expect there would be further consultation with the debenture sector on the changes to be introduced.

B Capital and liquidity requirements

Key points

Disclosures made by retail debenture issuing lenders reveal that few of these issuers maintain significant capital or adequate levels of liquid assets. This means that these businesses have a limited ability to successfully continue if adverse events occur, such as significant loan defaults. Despite these disclosures, retail investors have continued to invest in these issuers' debentures.

We therefore propose that retail debenture issuing lenders (whether listed or unlisted) should be required to:

- have a minimum capital ratio of 8% of their risk-weighted assets; and
- have a minimum holding of 9% of their liabilities in high-quality liquid assets.

Retail debenture issuing lenders that fail to meet the capital and liquidity requirements would be prevented from raising funds from retail investors.

Capital and liquidity requirements

Proposal

Application of our proposed capital and liquidity requirements

B1 We propose that mandatory capital and liquidity requirements should apply to an entity (issuer) that borrows or has borrowed money from retail investors through the issue of debentures under a disclosure document where those funds are ultimately used:

(a) in the course of carrying on a business that ordinarily involves providing finance or other advances of money to persons or entities outside the issuer's group; or

(b) to fund (directly or indirectly) property lending, development and investments and these funds in aggregate are more than 10% of the issuer's total assets.

Note: In this consultation paper, we call these entities 'retail debenture issuing lenders'.

Your feedback

B1Q1 Do you consider that our proposed definition of 'retail debenture issuing lenders' appropriately describes debenture issuers who offer products that have similar characteristics to deposits offered by ADIs (but are not ADIs) and are engaged in lending?

B1Q2 Do you think that our definition of 'retail debenture issuing lenders' is too wide or too narrow, and if so, why? Specifically, should limb (a) of our definition be narrowed to apply only to debenture issuers who provide finance or other advances of money to persons or entities outside the issuer's group for property -related lending, development or investment?

B1Q3 Are there any other debenture issuers who should comply with the proposed capital and liquidity requirements but who would not come within our proposed definition?

B1Q4 Are there any debenture issuers within the definition who should not be subject to our proposed capital and liquidity requirements? If so, please identify the type of issuers and why you do not think they should be subject to capital and liquidity requirements.

Rationale

19 Debenture issuers that raise funds from retail investors and on-lend those funds would need to be prudentially regulated under the *Banking Act 1959* if it were not for administrative exemptions that have been in place for many years. This position was discussed in the Financial System Inquiry of 1997 (known as the 'Wallis Inquiry'). The Wallis Inquiry concluded that there was no need for prudential regulation at that time on the grounds of investor protection or financial system stability, stating:

> Since finance companies' liabilities are longer term with less than 5% at call, and since the maturity mismatch is minor, the threat of a run or contagion is remote. Several have failed over the past two decades without threatening system stability: Chapter 8 of the Wallis Inquiry Report at pages 351–2.

20 The policy objective of our proposed capital and liquidity requirements is to strengthen the financial position of debenture issuers who have a business model that involves borrowing funds from retail investors to finance a range of activities, including mortgage financing and property development. These financing activities are a form of 'shadow banking'.

21 Shadow banking has been defined by the Financial Stability Board (FSB) as 'credit intermediation involving entities and activities outside the regular banking system'. There has been a growing interest internationally in monitoring and assessing the risks posed by the 'shadow banking' system.

22 Our definition of 'retail debenture issuing lenders' covers the part of the debenture sector that has encountered the most difficulties in the past and that provides products with some characteristics similar to deposits offered by ADIs. We consider that it accurately identifies the entities with a financing business model that require a stronger financial position.

23 Retail debenture issuing lenders account for a relatively small share of financial system assets and do not necessarily threaten the financial system as a whole. However, the recent collapse of Banksia Securities Ltd and other similar debenture issuers shows that their failure can have a significant regional impact and may affect broader consumer confidence. Our recent regulatory experience also suggests that disclosure alone may not be sufficient to deal with the issues raised in this sector.

> Note: Registered financial corporations, which include household financiers, commercial financiers, and motor vehicle financiers, in each case that are not prudentially regulated by APRA, constituted approximately 4% of Australia's total domestic financial system assets in 2012.

24 Our proposed capital and liquidity requirements are aimed at ensuring that:

(a) retail debenture issuing lenders maintain appropriate financial resources to conduct their business;

(b) retail debenture issuing lenders are more resilient to adverse economic changes;

(c) there is a financial buffer that decreases the risk of a disorderly winding up if the business fails; and

(d) there are incentives for the issuer's owners to undertake prudent management of the business because they have 'skin in the game'.

25 However, the proposed capital and liquidity requirements will not prevent debenture issuers from becoming insolvent. Investors will still risk all their capital when investing in debentures issued by these companies. For this reason, debenture issuers will still need to give investors prominent and upfront disclosures that they are not regulated by APRA and are not subject to depositors' protection provisions or the Financial Claims Scheme.

26 We propose that retail debenture issuing lenders who fail to comply with the capital and liquidity requirements should not be permitted to raise funds from retail investors: see proposal B7.

Proposal

Retail debenture issuing lenders to maintain capital ratio of 8% of risk-weighted assets

B2 We propose that retail debenture issuing lenders should be required to have a minimum capital ratio of 8% of their total risk-weighted assets, calculated as follows:

$$\text{Risk-based capital ratio} = \frac{\text{Capital base}}{\text{Total risk-weighted assets}}$$

where:

(a) *capital base* is defined as the funding sources to which an entity can most easily allocate losses without triggering insolvency. It

means issued capital, reserves, retained earnings and non-redeemable preference shares, net of deductions;

(b) *deductions* are defined as assets that have little or no value in an insolvency situation, such as goodwill, deferred tax assets and off-balance sheet assets; and

(c) *risk-weighted assets* are defined as a measure of the entity's on-balance sheet assets, adjusted for risk. Risk weighting adjusts the value of an asset for risk by multiplying it by a factor that reflects its risk. Low-risk assets are multiplied by a low number, and high-risk assets are multiplied by a higher number (100% or more in the case of assets that are very unlikely to be available to absorb losses). These are set out in detail at proposal B4.

Your feedback

B2Q1 Do you agree that retail debenture issuing lenders should be subject to minimum capital requirements?

B2Q2 If so, is the proposed capital requirement of 8% of risk-weighted assets high enough to reflect industry risk and the fact that debenture issuers will not be subject to prudential supervision?

B2Q3 Do you agree with the proposal for calculating the capital ratio (i.e. capital base minus deductions divided by total risk-weighted assets)?

B2Q4 Do you agree with the proposed concept of 'capital base' and its inclusions?

B2Q5 Do you agree with the proposed concept of 'deductions', which reduce the capital base?

B2Q6 Are there any other obligations that should apply to an issuer to ensure that the calculations (e.g. of the issuer's assets) are appropriate and accurate?

B2Q7 Should the fact that debenture holders may have a security interest over particular assets of the issuer be taken into account when imposing the proposed capital requirements and, if so, how?

B2Q8 What changes to the operations of issuers will occur if these capital requirements are implemented?

B2Q9 Will issuers have any practical difficulties in meeting and maintaining our minimum capital requirements? Please estimate the likely cost.

Rationale

27 Benchmark 1 in RG 69 recommends that issuers have a minimum capital ratio of 8% (or 20% if they are involved in property development). This is calculated simply as total equity divided by total liabilities and total equity.

28 Few debenture issuers comply with RG 69's Benchmark 1, and insufficient capitalisation continues to be a contributing factor to failures experienced in

the sector. It is clear that many retail debenture issuing lenders have not had sufficient focus on the capital requirements for their business. For this reason, we are proposing that retail debenture issuing lenders be required to comply with a mandatory 8% minimum capital ratio.

29 If a mandatory capital requirement is imposed, we think it is important that the capital requirement be carefully calculated having regard to the nature of the assets and liabilities of the business. Framing capital requirements in these terms should encourage retail debenture issuing lenders to actively monitor and focus on their key capital risks.

30 Our proposed capital requirements should not, however, be taken as a basis for assuming that retail debenture issuing lenders will not fail in the future.

Proposal

Possible discretionary power to change the 8% capital requirement

B3 We are proposing that there should be a discretionary power for ASIC to raise or lower the 8% minimum capital threshold on a case-by-case basis.

Your feedback

B3Q1 Do you agree that ASIC should be given this power? Why or why not?

B3Q2 If there is a discretionary power, what kind of circumstances should be considered in deciding whether to raise or lower the capital requirement?

Rationale

31 It is proposed that trustees will supervise debenture issuers' compliance with our proposed minimum capital and liquidity requirements. The requirements will not be part of a regime involving prudential supervision. Prudential supervision involves a regulator having a high degree of continuous engagement with the business of the supervised entity and extensive powers to intervene with a view to reducing the likelihood of failure of the business. Trustees will not be able to supervise debenture issuers to this extent and nor will they have the extensive legislative powers of a prudential regulator. Further, debentures are not covered by the Financial Claims Scheme (under which the Government 'guarantees' deposits with an ADI up to $250,000 per depositor).

32 For these reasons, we consider it is appropriate that ASIC should have a discretionary power to vary a debenture issuer's minimum capital requirement in certain circumstances.

Proposal

Risk weighting assets

B4 We are proposing that debenture issuers' assets should be risk weighted, as set out in Table 2. If multiple categories apply to any particular investment, the highest risk weighting should be adopted.

Your feedback

B4Q1 Do you have any comments on our general approach to risk weighting assets?

B4Q2 Do you consider that we have identified appropriate risk weightings for the different categories of assets?

B4Q3 Are there other claims that should receive a higher risk weighting than 100% when they are more than 90 days overdue, impaired or non-accruing?

B4Q4 Is there any common asset category that we have not identified? If so, what would be the appropriate risk weighting for that asset?

B4Q5 Are there any other obligations (e.g. audit or other review requirements) that should apply to an issuer to ensure that the calculations (e.g. of the issuer's assets) are appropriate and accurate?

B4Q6 What changes to the operations of issuers will occur if these capital requirements are implemented? Are there practical difficulties for issuers in maintaining the minimum capital requirement?

B4Q7 Some of our risk weightings are conservative, given the absence of prudential supervision in the debenture sector. Do you agree with this approach?

B4Q8 Do you consider that the risk weighting for assets that relate to property development activities is high enough? If not, how high should it be?

Table 2: Categories of risk

Category	Asset class	Risk	Risk weight (%)
A	Cash items	Notes and coins	0
		Claims (other than equity) on authorised deposit-taking institutions (including cash items in the process of collection with an ADI, such as cheques)	20
B	Australian federal and state government and semi-government	Claims on Australian federal and state governments (not exceeding 12 months to maturity)	0

Category	Asset class	Risk	Risk weight (%)
		Other claims on federal and state governments exceeding 12 months to maturity	10
		Claims on local government and non-commercial public sector entities	20
C	Eligible residential mortgages	Claims secured by a first-ranking residential mortgage where the outstanding amounts including interest do not exceed 60% of either the amount set out in a valuation less than 12 months old, or where there is no valuation less than 12 months old, the capital improved value in the most recent municipal rates notice for the property	50
D	Property development related assets	Claims for the purpose of, or secured by, construction or property development	150
E	Related party claims	Claims against a related party of the issuer	200
F	90-day past due claims, including non-accrual claims	Claims secured by first ranking residential mortgages that are: • past due by more than 90 days and/or impaired; or • treated as non-accrual claims.	100
		Claims in category D that are: • past due by more than 90 days and/or impaired; or • treated as non-accrual claims	200
		Claims in category E that are: • past due by more than 90 days and/or impaired; or • treated as non-accrual claims	250
		The unsecured portion of any claim (other than a claim identified above) that is: • past due by more than 90 days and/or impaired; or • treated as a non-accrual claim; is weighted as follows: • where specific provisions are less than 20% of the outstanding amount; • where specific provisions are no less than 20% of the outstanding amount	 150 100
G	Claims of capitalised interest	Claims of capitalised interest for the purpose of, or secured by, construction or property development, or for other claims of capitalised interest that relate to claims where the loan-to-valuation ratio (including unpaid interest) is more than 80%	200
H	Other claims and assets	All other assets not in categories A to G	100

Note: A claim is impaired if there is doubt over the timely collection of the full amount of cash flows contracted to be received by the issuer.

Rationale

33 The minimum capital requirements we are proposing for retail debenture issuing lenders have been proposed having regard to the prudential standards that apply to ADIs carrying on lending activities. However, having regard to the different purpose and complexity of these standards, our proposal differs in a number of significant ways. We consider our simpler risk weighting will be more appropriate to the smaller scale operations of debenture issuers. Our simpler requirements will also be easier for debenture issuers and trustees to monitor.

34 Our proposed risk weighting is conservative because debenture issuers often have a higher-risk business model than ADIs and, unlike ADIs, they will not be subject to prudential supervision. Further, there is no proposal to introduce the full range of prudential standards that apply to ADIs to debenture issuers.

Liquidity requirements

Proposal

Retail debenture issuing lenders to maintain 9% of liabilities in liquid assets

B5 We are proposing that retail debenture issuing lenders should maintain a minimum holding of 9% of their liabilities in high-quality liquid assets, where:

(a) *liabilities* are defined as total on-balance sheet liabilities (including equity) and irrevocable commitments less the capital base;

(b) *capital base* is defined as the funding sources to which an entity can most easily allocate losses without triggering insolvency. It means issued capital reserves, retained earnings and non-redeemable preference shares, net of deductions;

(c) *deductions* are defined as assets that have little or no value in an insolvency situation, such as goodwill, deferred tax assets and off-balance sheet assets; and

(d) *high-quality liquid assets* are defined as unencumbered:

(i) cash;

(ii) money on deposit with an ADI (at call or readily convertible to cash within two business days); and

(iii) marketable securities representing claims on or claims guaranteed by the Australian Government or the government of any Australian state or territory.

Your feedback

B5Q1 Do you agree with the general concept that retail debenture issuing lenders should maintain a minimum holding of 9% of their liabilities in high-quality liquid assets at all times?

B5Q2 Do you agree with the definitions of 'liabilities', 'capital base', 'deductions' and 'high-quality liquid assets'?

B5Q3 What changes to the operations of issuers will occur if these liquidity requirements are implemented?

B5Q4 Will issuers have any practical difficulties in meeting and maintaining our proposed minimum liquidity requirements? Please estimate the likely cost.

Rationale

35 Because of the *Banking Act 1959* exemptions referred to above, debenture issuers are not subject to the liquidity requirements that apply to ADIs. However, adequate liquidity is key to an entity's short-term financial health and its ability to meet obligations to investors.

36 Insufficient liquid assets have been a contributing factor in past failures (even if the issuer is otherwise well capitalised). For these reasons, we propose that retail debenture issuing lenders should be subject to a 9% liquidity requirement broadly similar to that applying to ADIs.

Monitoring and supervision of capital and liquidity requirements

Proposal

Retail debenture issuing lenders to monitor their capital and liquidity

B6 We consider that an issuer's obligation under Ch 2L of the Corporations Act to carry on and conduct its business in a proper and efficient manner would require it to monitor its capital and liquidity position against the proposed minimum requirements if these are implemented. We would expect an issuer to:

(a) review its capital base, deductions, risk-weighted assets, liabilities and high-quality liquid assets on an ongoing basis to determine whether it meets the 8% capital requirement and the 9% liquidity requirement;

(b) periodically make projections about its capital—for example, testing whether it could comply with the capital requirement if:

(i) its business were to continue in accordance with past trends; or

(ii) there were significant adverse impacts on the business (e.g. a portion of its loans had to be revalued);

(c) appropriately update its asset values on an ongoing basis—for example:

(i) loans secured by property should be revalued if the issuer becomes aware of a material change in the market value of property in an area or region; and

(ii) construction or development loans should be valued on an 'as is' as well as an 'on completion' basis; and

(d) periodically 'stress test' its liquidity—for example, testing whether it could comply with the liquidity requirement:

(i) if it was unable to raise new funds under a prospectus;

(ii) if there was a withdrawal of an overdraft or other credit facility on which the issuer relies; and

(iii) if there was a significant reduction of 5% or more in the rate of rollovers.

Your feedback

B6Q1 Are our proposed monitoring requirements appropriate? If not, what other monitoring do you suggest?

B6Q2 Please estimate any costs that issuers will incur in monitoring their capital and liquidity ratios?

B6Q3 Do you agree that the obligation for the issuer to carry on and conduct its business in a fair and efficient manner is sufficient to ensure that issuers are required to monitor the capital and liquidity requirements? If not, what specific obligations should be imposed on issuers for monitoring these requirements?

B6Q4 Should there be more explicit rules around valuations of assets applicable to retail debenture issuing lenders?

Rationale

37 If the capital and liquidity requirements are imposed, issuers would need to adopt systems for monitoring their capital and liquidity on a real-time basis. Without these systems, neither the issuer nor the trustee is in a position to assess whether the requirements have been met.

38 It will also be important that the inputs for these requirements are sound—in particular, valuations of assets on which these calculations are based must be reliable. To ensure that issuers can comply with the requirements at all times, it would be necessary for issuers to make projections about their capital and liquidity in the future. A variety of assumptions should be used in deriving these projections so that a range of possibilities are considered. In particular, issuers should not base their projections on unrealistic or overly optimistic assumptions or valuations.

Proposal

Trustees to supervise issuers' compliance with capital and liquidity requirements

B7 We propose that:

(a) the law should require debenture trust deeds to contain the minimum capital and liquidity requirements proposed in this paper;

(b) the law should require trustees to exercise reasonable diligence to ascertain whether the issuer has complied with the capital and liquidity requirements (either specifically or through the general requirement in s283DA(b)(ii) to monitor compliance with the trust deed);

(c) the law should provide that issuers are only permitted to raise funds and roll over investments from retail investors if issuers comply with the capital and liquidity requirements at the time that the funds are accepted; and

(d) the law should provide that issuers must immediately notify their trustee and ASIC if they no longer comply with the capital and liquidity requirements.

Your feedback

B7Q1 Do you agree that trustees should have responsibility for supervising debenture issuers' compliance with the minimum capital and liquidity requirements?

B7Q2 What costs will this involve for trustees?

B7Q3 Do you agree that issuers should not be able to raise further funds if they do not comply with the capital and liquidity requirements? Is the correct time to test this at the time that the funds are accepted, or another time? Why?

B7Q4 Should a breach of capital and/or liquidity requirements automatically trigger an event of default power by the trustee, an automatic winding up of the company, court action by the trustee or ASIC, or some other action? If so, should any proposed trigger event be legislated or left as a matter for the trustee?

B7Q5 To what extent should directors be held liable for a breach of capital or liquidity requirements?

B7Q6 Do you think there should be any other consequences if the capital and liquidity requirements are not met? If so, please specify what consequences would be desirable.

Rationale

39 We propose that retail debenture issuing lenders that do not comply with the capital and liquidity requirements should not be permitted to raise funds from retail investors. In practice, this is likely to mean that these debenture issuers will need to maintain a buffer of capital and liquidity and make

projections about these matters on an ongoing basis to ensure that raising funds from retail investors can occur continuously.

40 Raising further funds from retail investors may be the easiest way to gain further liquidity in some instances and therefore assist in avoiding business failure. However, as a debenture business begins to have problems with its capital and liquidity, what may occur is that new retail investors essentially fund the repayment of exiting investors. We do not think that this would be an appropriate result.

41 Sources of capital and liquidity other than retail investor funds will need to be found if a debenture issuer is in need of capital or liquidity. For instance, the issuer could obtain funds from its shareholders.

42 We are considering whether a breach of capital and/or liquidity requirements should automatically trigger some action by either the trustee or ASIC to protect investors. Such actions may include the exercise of an event of default power by the trustee, an automatic winding up of the issuer, court action, or some other alternative.

43 Debenture trustees and ASIC already have the ability to approach a court for a number of orders under s283BH. If the capital and liquidity requirements are not met by an issuer and there is no immediate solution to addressing the deficiency, trustees or ASIC may need to consider whether it is in investors' interests to approach the court for orders (if some other action is not automatically triggered by the breach).

Other reforms to strengthen the financial position of retail debenture issuing lenders?

Issue

B8 We are seeking feedback about whether further reforms are needed to strengthen the financial position of retail debenture issuing lenders.

Your feedback

B8Q1 Are there any other reforms that should be introduced to strengthen the financial position of retail debenture issuing lenders?

B8Q2 Are there any additional requirements we should consider in relation to provisioning?

B8Q3 Are there any additional requirements we should consider in relation to the non-accrual status of loans, or is this adequately dealt with under the accounting standards?

B8Q4 What impact do you think the proposed standards would have on the structure of the retail debenture issuing lender sector and the number of entities in this sector?

Rationale

44 Our proposed capital and liquidity requirements will improve the financial strength of retail debenture issuing lenders but they will not prevent insolvencies. At this point, we consider that our proposals strike the appropriate balance between improving the financial strength of retail debenture issuing lenders and maintaining regulation at a sustainable level (i.e. at a level where finance companies can continue to operate). We are seeking feedback on whether further measures are appropriate.

Transitional arrangements

Proposal

Phased transition period of four years

B9 We are proposing that liquidity requirements for retail debenture issuing lenders will come into effect four years after commencement of any new requirement. The capital requirements will be phased in over a four-year period, as follows:

(a) 18 months following commencement: issuers need to hold 50% of the capital requirement (i.e. a capital ratio of 4% of risk-weighted assets);

(b) three years following commencement: issuers need to hold 75% of the capital requirement (i.e. a capital ratio of 6% of risk-weighted assets); and

(c) four years following commencement: issuers need to hold 100% of the capital requirement (i.e. a capital ratio of 8% of risk-weighted assets).

Note: Once the minimum capital and liquidity requirements have come into effect, it is likely that we will make consequential changes to RG 69 for retail debenture issuing lenders (e.g. removing Benchmarks 1 and 2).

Your feedback

B9Q1 Do you consider the proposed transitional arrangements are appropriate? If not, what transitional arrangements would be adequate?

Rationale

45 The introduction of capital and liquidity requirements would have a significant effect on the debenture sector and, currently, few issuers could comply with both sets of requirements. We are proposing that the requirements apply to both listed and unlisted retail debenture issuing lenders.

46 We are recommending a phased transition period over four years so that issuers have sufficient time to increase their capital and liquidity or make arrangements to change their business.

C Powers and duties of trustees

Key points

Under Ch 2L of the Corporations Act, trustees have an important role in monitoring the financial position of debenture issuers to help protect the interests of retail investors.

We propose that the law should be amended to clarify that there are explicit obligations for a trustee to:

- exercise reasonable diligence to regularly assess and form a view on the issuer's financial position, performance and viability;
- exercise reasonable diligence to ensure that material information provided in the issuer's prospectus is correct and current; and
- monitor whether the issuer has adequate resources to meet the issuer's obligations to debenture holders.

We are also proposing that trustees should have more powers and greater access to information to enable them to perform this role.

Clarifying the role of trustees under Ch 2L

Proposal

Trustee to regularly assess issuer's financial position, performance and viability

C1 We consider that s283DA of the Corporations Act implicitly requires a trustee to exercise reasonable diligence to regularly assess and form an opinion on an issuer's financial position, performance and viability. To clarify this requirement, we propose that the law should be amended to set out explicit obligations for trustees to exercise reasonable diligence to regularly assess and form an opinion on the issuer's financial position, performance and viability, including a critical review of provisioning arrangements.

We propose that the assessment should be made at least quarterly and that there should be an explicit requirement for the trustee to provide a copy of their opinion to the issuer, any guarantor, and ASIC (but not to debenture holders).

Note: Proposal C2 sets out some proposed guidance on what this duty would entail.

Your feedback

C1Q1 Will trustees have any practical issues with formally forming an opinion on the issuer's financial position, performance and viability?

C1Q2 We are proposing that trustees should perform this assessment at least quarterly, and more often if the issuer's financial position requires more frequent monitoring. Is this frequency appropriate? If not, what frequency would be appropriate?

C1Q3 Should trustees' reporting obligations be explicitly set out in legislation, or would you consider guidance to be more appropriate, and why?

C1Q4 Do you consider that trustees should communicate their opinion to ASIC, the issuer and the issuer's auditor?

C1Q5 We are not proposing that trustees should communicate their opinion on the issuer's financial position, performance and viability to debenture holders. Do you agree with this approach?

C1Q6 Are trustees' current obligations sufficient to ensure that they are obliged to take appropriate action if the information they receive indicates concerns with the issuer's financial position, performance and viability?

Proposal

Guidance on assessing financial position, performance and viability

C2 If proposal C1 is implemented, we are proposing that the trustee's duty to assess an issuer's financial position, performance and viability would include:

(a) that the trustee should asses the issuer's compliance with relevant financial services laws, including ASIC guidance about these laws; and

(b) for retail debenture issuing lenders, that the trustee would exercise reasonable diligence in assessing:

(i) the extent of arrears relative to key financial indicators (e.g. net assets, total loan book value, and any provision or reserve);

(ii) the extent of non-performing loans or mortgagee in possession of assets and whether they are being realised in a prudent and timely way;

(iii) indicators of impairment;

(iv) dated valuations of underlying security; and

(v) the amount of interest being paid or accrued to debenture holders or financiers relative to interest funds being received from the issuer's borrowers.

Your feedback

C2Q1 Do you consider that trustees will benefit from some specific indication in the law, or through guidance, about what is involved in assessing the issuer's financial position, performance and viability (proposal C1)?

C2Q2 Do you agree with proposal C2 (i.e. our indication of what the trustee's duty to assess the issuer's financial position, performance and viability would involve)? If not, what do you consider that regularly assessing an issuer's financial position, performance and viability would involve?

Rationale

47 Chapter 2L of the Corporations Act gives trustees an important role of monitoring the issuer's financial position. If an issuer experiences financial difficulties, the trustee plays a key role in ensuring the equal treatment of investors by applying to the court to freeze new issues and redemptions.

48 Section 283DA requires the trustee to:

(a) exercise reasonable diligence to ascertain whether the property of the borrower and each guarantor will be sufficient to repay the amount deposited or lent when it falls due; and

(b) exercise reasonable diligence to ascertain whether the borrower or any guarantor is in breach of the terms of the debentures, the provisions of the trust deed or Ch 2L.

49 These current obligations focus on identifying when a debenture issuer is in severe financial difficulties. Debenture holders may have lost a significant proportion of their investment by this time (i.e. by the time the borrower does not have sufficient property to repay the amounts lent).

50 We consider that there would be great benefit in trustees taking a more proactive approach. This would include regularly assessing and forming an opinion on the issuer's viability—including the issuer's performance against the benchmarks in RG 69 (if the issuer is required to report against RG 69), and to report that opinion to the issuer, any guarantor and ASIC.

51 It will also assist the trustee in obtaining information from the issuer if trustees can point to an express obligation to consider these broader matters. It might also be useful in drawing the court's attention to matters relevant to debenture holders if an application for orders is made to the court under s283BH.

52 Some trustees already monitor the issuer's property that is relevant to the prospects of investors being repaid when due. We consider that an express legal obligation to monitor the financial viability of the issuer will help ensure that all trustees take into account a broader range of factors under the law in assessing the investors' prospects of being repaid.

Proposal

Trustees to ensure issuer's disclosure is correct and current

C3 We propose that the law should be amended so that trustees have an obligation to exercise reasonable diligence to ensure that material information provided by the issuer in its prospectus is correct and current. Debenture issuers would be required to provide reasonable assistance to trustees to undertake this role: see proposal C5. The prospectus would include a statement to the effect that the trustee has undertaken this exercise.

Your feedback

C3Q1 Do you consider that requiring trustees to exercise reasonable diligence to ensure that material information in the issuer's prospectus is correct and current will help retail investors make informed investment decisions?

C3Q2 Will the proposed obligation be onerous for trustees? Please estimate the likely cost.

C3Q3 Should the legislation provide that trustees have a defence to liability if the material information is not correct and current? If so, should it be modelled on Ch 6D defences of reasonable diligence and reasonable reliance?

C3Q4 Will trustees have sufficient powers and access to information to carry out this role (taking into account our other proposals at C5–C7)?

Rationale

53 We consider that the trustee should have an obligation to exercise reasonable diligence to ensure that material information in prospectuses is correct and current. This is because the trustee has a role in overseeing the operations of debenture issuers for the benefit of retail investors.

Proposal

Trustees to monitor issuers' resources

C4 We propose that trustees should have an obligation to monitor whether the debenture issuer has adequate resources (including financial, technological and human resources) to meet the terms of the debentures, the provisions of the trust deed and the law.

Your feedback

C4Q1 Do you agree that the law should require trustees to monitor whether the issuer has adequate resources to meet their obligations to debenture holders?

C4Q2 Should the law or guidance specify what adequate resources are required for different businesses, or is this better assessed by the trustee on a case-by-case basis?

C4Q3 Should the debenture issuer be required to demonstrate to the trustee on a regular basis that its management, including directors, has sufficient experience and skills to manage the issuer's business?

C4Q4 Should the law or guidance prescribe the types of experience, skills and qualifications held by the issuer's key personnel (e.g. directors)?

C4Q5 Do any additional obligations need to be imposed on the issuer to have adequate resources, or is the obligation in s283BB(a) sufficient?

Rationale

54 Some failures in the debenture sector can be partly attributed to the fact that the issuer did not have adequate resources to carry on its business. A lending business is clearly vulnerable if the lending criteria are inappropriate and there is insufficient experience with monitoring and collecting loans in arrears.

55 Although most debenture issuers have an Australian financial services (AFS) licence, the AFS licence conditions are focused on self-dealing activities and the provision of financial advice (depending on the issuer's activities). These are generally a narrow component of the issuer's business, and therefore the AFS licence does not provide a regulatory regime for the remaining activities undertaken by the issuer. The AFS licence requirements are not intended to minimise the risk of a business from failing because of insufficient resources, or to ensure that an issuer can meet obligations to debenture holders: see Regulatory Guide 166 *Licensing: Financial resource requirements* (RG 166) at RG 166.5.

56 For this reason, we consider that trustees should monitor whether an issuer has sufficient resources to meet its obligations to debenture holders. The resources that an issuer needs to meet these obligations will depend on the type of business conducted.

57 For example, if the company conducts a finance business, the directors should have appropriate financial knowledge and skills. This would generally include skills in formulating lending criteria, assessing creditworthiness and provisioning. These are the kind of skills that might have been acquired through, for example, employment in bank lending.

58 Having adequate resources is implicitly part of the issuer's obligation to carry on and conduct their business in a proper and efficient manner, as set out in s283BB. In addition, whether or not a breach of the Corporations Act has occurred, trustees can approach the court for orders if they think it is in the interests of debenture holders. The issuer's resources may be an important consideration in the trustee's decision about whether it would be appropriate to seek orders from the court.

Improved access to information for trustees

Proposal

Giving trustees power to request information

C5 We propose that the law should be amended so that a trustee has express powers to obtain information from the debenture issuer to supplement and give full effect to the issuer's current obligation to provide information under Ch 2L.

Under this proposal, the trustee would have the right to:

(a) require the issuer to provide, as soon as is reasonably practicable, information to the trustee about the issuer's financial position and business;

(b) access the issuer's business, premises and records;

(c) ask questions of the issuer's board and management; and

(d) require the issuer to appoint an expert or other professional nominated by the trustee to prepare any report, analysis or advice for the trustee at the issuer's expense. For example, the trustee may require the issuer to obtain a valuation of the issuer's assets by a valuer nominated by the trustee, and then provide that valuation to the trustee. The trustee may also require the issuer to appoint an investigating accountant to prepare a report for the trustee on the issuer's financial position, performance and viability.

Your feedback

C5Q1 What limitations, if any, should there be on the type of information that the trustee can request? Please estimate the likely cost for issuers.

C5Q2 Do you agree that the debenture issuer should provide information to the trustee within a reasonable period of time?

C5Q3 It has been suggested that trustees should have a role in the appointment of the issuer's auditor. Do you agree? For example, should the trustee have the power to veto new appointments? If so, should this power only apply in the case of retail debenture issuing lenders?

Rationale

59 A trustee's main duties involve monitoring the issuer's property and taking action if it deteriorates or is not sufficient to repay investors. Trustees need to be able to access reliable and current information to perform these duties. This will particularly be the case if trustees have responsibility for monitoring the issuer's compliance with minimum capital and liquidity requirements (as proposed at B7) and prospectus disclosures to the market (as proposed at C3).

60 Currently, an issuer must make its records available to the trustee if requested: s283BB. Chapter 2L also requires an issuer to provide certain specified information to trustees on a periodic basis. For example, the issuer must give the trustee:

(a) written details of any security interest created within 21 days (s283BE(a));

(b) details of certain advances under the security interest within seven days (s238BE(b)); and

(c) quarterly reports setting out the information required by s283BF(4)–(6).

61 We consider that trustees need the express power to obtain information on an 'as needs' basis so that they can accurately assess the issuer's financial position. Trustees should not be restricted to periodic information because a debenture issuer's financial position can deteriorate rapidly (e.g. as a result of market conditions). If an issuer did not respond to a trustee's request, the trustee could report this failure to ASIC, or apply to the court for appropriate orders.

62 Trustees should also have the express power to obtain information about the issuer from an independent source (e.g. an investigating accountant or valuer).

Application and transitional arrangements

Proposal

Reforms to apply across the retail debenture sector

C6 We are proposing that proposals C1–C5 should apply to the retail debenture sector broadly—that is, to entities that issue debentures, whether or not they are listed and whether or not the issuer on-lends.

Your feedback

C6Q1 Do you agree with the application of the proposals?

C6Q2 If not, what do you recommend and why?

Rationale

63 We consider that the reforms outlined in this Section C should apply broadly across the debenture sector. This is because it is desirable to clarify and harmonise the role of trustees for all debenture offerings regardless of whether or not the debenture issuer is listed or unlisted, or is a lender or borrows for its own purposes.

64 In RG 69 we distinguish between listed and unlisted products, but the need for this distinction is not as clear when considering the need for trustees to effectively monitor the issuer's financial viability.

Proposal

Transition period of 12 months

C7 We are proposing that the amendments in C1–C5 should have a limited transition period of 12 months (i.e. they take effect no later than 12 months after commencement).

Your feedback

C7Q1 Do you agree that the proposed amendments to the trustee's role and powers should have a transition period of 12 months? If not, what transition period do you recommend and why?

Rationale

65 We are proposing that the reforms would have a relatively short transition period of 12 months, consistent with the proposed reforms for auditors of debenture issuers. This is because, in our view, proposals C1–C4 in relation to the trustee's role reflect existing good practice. We consider that trustees need greater powers to obtain access to information (proposal C5) to fully undertake their statutory role.

D Enhanced role for auditors

Key points

Auditors can play a key role in ensuring that trustees have reliable information.

We propose that the law should be amended so that auditors are required to give the audited annual report and reviewed half-yearly report directly to the trustee, and answer any reasonable questions the trustee asks. In addition, we propose that the law should be amended so that auditors are obliged to report directly to the trustee if the auditor becomes aware of any matter likely to be prejudicial to debenture holders or relevant to the exercise of the trustee's powers.

These proposed reforms will apply to auditors of all listed and unlisted debenture issuers, not just retail debenture issuing lenders. As a result, they will apply to companies issuing retail corporate bonds.

Requirement for twice-yearly report to the trustee

Proposal

Auditors to report to the trustee

D1 We propose that the law should be amended so that debenture issuers must engage their auditor to report directly to the trustee twice per year and answer any reasonable questions the trustee asks. The reports provided would be the audited annual report and reviewed half-yearly report.

In addition, we propose that the obligation in s313(2) to report to the debenture issuer on any matters that come to the auditor's attention that are likely to be prejudicial to debenture holders or relevant to the exercise of the trustee's powers should be expanded to require that this report should also be given directly to the trustee.

Your feedback

D1Q1 Do you agree that the auditor should be required to directly report to and communicate with the trustee? Will this help trustees to better exercise their powers and perform their duties?

D1Q2 Will this proposal better focus the auditor's attention on the role the auditor plays in relation to the debenture holders?

D1Q3 In addition to the current obligations under the Corporations Act, are there any further matters on which the auditor should be obliged to report?

D1Q4 Please estimate the likely cost of this proposal for issuers, trustees and auditors (in particular, the auditor being required to answer any questions the trustee asks). Do you consider that the proposal would be cost-effective?

D1Q5 Do you think that auditors should have any positive obligations to make inquiries or produce reports, other than those currently required under the Corporations Act or proposed above?

Rationale

66 Trustees need access to independent and current information on the issuer's assets and liabilities in order to fulfil their obligations to debenture holders. Trustees currently have access to the issuer's audited annual report and reviewed half-yearly report. However, these reports are not addressed directly to the trustee and the trustee may encounter difficulties in questioning the auditor about the content of these reports.

67 Auditors have an existing obligation under s313(2) to report to the debenture issuer or guarantor any matter that comes to their attention in conducting an audit or review that is likely to be prejudicial to the interests of debenture holders. Although this report must also be copied to the trustee, some of the failures in the debenture sector suggest that auditors are not sufficiently focused on this obligation and the role that they play in ensuring that the trustee has sufficient information.

68 For this reason, we consider that issuers should have an active obligation to engage their auditor to report to the trustee in relation to the annual and half yearly financial reports of the debenture issuer. In addition, we also propose that the law should be amended to ensure that any report under s313(2) be prepared as a report to the trustee as well as to the debenture issuer, rather than simply copied to the trustee.

69 We consider the existing law already requires auditors to undertake work such as questioning provisioning policies and practices and reviewing valuations and seeking updated valuations where necessary.

70 However, our proposal would also oblige auditors to answer reasonable questions put to them by the trustee, and to make any necessary enquiries to answer those questions. We consider this enhanced communication between auditors and trustees will help trustees to monitor debenture issuers more effectively.

Application and transitional arrangements

Proposal

Reforms to apply across sector

D2 We are proposing that the requirement for auditors to report directly to the trustee and to answer any reasonable questions of the trustee should apply to the debenture sector generally.

Your feedback

D2Q1 Do you agree that this requirement should apply to the debenture sector generally, or should it only apply to retail debenture issuing lenders?

Rationale

71 We consider that the requirements about auditor's reporting directly to the trustee and answering the trustee's reasonable questions should apply to the debenture sector generally so that trustees are able to perform their enhanced role.

Proposal

Transition period of 12 months

D3 We propose that the requirement for the auditor to report directly to the trustee and to answer the trustee's reasonable questions should come into effect after a transition period of 12 months.

Your feedback

D3Q1 Do you agree that a transition period of 12 months after the next end of financial year will be sufficient? If not, what transition period would be appropriate?

Rationale

72 We are recommending that the requirement for issuers to require their auditors to report directly to the trustee and answer any reasonable questions from the trustee should come into effect in financial reporting periods beginning after a 12-month transition period so that it would take effect in an audit or review period that has not commenced.

E Prospectus exemption for rollovers

Key points

We propose the Corporations Act should be amended so that retail debenture issuing lenders will be required to provide a prospectus to existing retail investors who make further debenture investments (including rollovers of existing investments).

We also seek feedback on whether retail debenture issuing lenders should be required to put continuous disclosure notices on their website.

Narrowing the scope of the exemption in s708(14) and better communication of continuous disclosure

Proposal

Issuers to provide prospectus for rollovers and further offers

E1 We propose that s708(14) of the Corporations Act should be amended so that retail debenture issuing lenders are required to provide a prospectus when existing retail investors make further debenture investments or roll over their debenture investments.

Your feedback

E1Q1 Do you agree that retail investors need a prospectus before deciding whether or not to leave their funds invested or make a further investment with a retail debenture issuing lender? If not, would a reduced form of disclosure be appropriate?

E1Q2 We are proposing that only retail debenture issuing lenders should be required to give a prospectus to existing retail investors. Do you consider this proposal should apply to all debenture issuers?

E1Q3 Will this requirement be onerous for debenture issuers? If so, please estimate the likely cost.

E1Q4 Should investors have to take some action to roll over their debenture investments (rather than rollovers happening automatically if they do not take action)?

E1Q5 Regulatory Guide 198 *Unlisted disclosing entities: Continuous disclosure obligations* (RG 198) recommends and facilitates unlisted debenture issuers putting their continuous disclosure notices on their website (as a matter of good practice). Should this be a legal requirement for retail debenture issuing lenders? Should this obligation apply more broadly to all debenture issuers?

Rationale

73 Often debentures are issued on the basis that the investment will be automatically rolled over for a further period after the initial period expires if the investor does not take action at that time. Benchmark 3 in RG 69 requires issuers to disclose their approach to rollovers in their initial prospectus, including whether the 'default' position is that debentures are automatically rolled over.

74 Currently, issuers have to give a prospectus to retail investors for their initial investment in the issuer's debentures but they do not have to give existing retail investors a prospectus for any further debenture investments (including rollovers of existing investments). This is due to the exemption in s708(14) of the Corporations Act for offers to existing debenture holders: see also paragraphs 89–90 in the appendix.

75 We consider that the scope of s708(14) should be narrowed so that retail debenture issuing lenders must provide a prospectus to investors when they are deciding whether to roll over their investment or whether to make a further debenture investment. This is because, particularly for businesses carrying on lending activities, circumstances can quickly change between the investor's initial investment (when they were given a prospectus) and the rollover or further offer of debentures. Over this time, cash flow, bad loans and liquidity levels may have changed significantly. Investors need a prospectus to assess these factors before making an investment decision. Also, investors making a decision based on a rollover prospectus would be entitled to remedies under the Corporations Act if the prospectus was materially defective (including withdrawal rights under s724 and, potentially, compensation under s729).

Transitional arrangements

Proposal

Transition period of six months

E2 We propose that the amendment to s708(14) in proposal E1 would take effect 12 months after the amendment is made.

Your feedback

E2Q1 Do you agree with this 12-month transition period for the proposed amendment to s708(14)? If not, what transition period do you recommend and why?

Rationale

76 We consider that the proposed amendment to s708(14) could come into effect with a 12-month transition period because most debenture issuers have a current prospectus and it should not be difficult for them to provide this to existing investors. In addition, a 12-month transition period should give issuers an opportunity to revise their systems as necessary.

F Regulatory and financial impact

77 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us, we think they will strike an appropriate balance between:

(a) ensuring that retail investors who invest in debentures are confident and informed; and

(b) maintaining regulation at a cost-effective level.

78 If appropriate, before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

(a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;

(b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and

(c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

79 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

80 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

(a) the likely compliance costs;

(b) the likely effect on competition; and

(c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

Appendix: ASIC's role in the debenture sector

Improving the disclosure regime

81 ASIC has focused on ensuring that investors in the unlisted, unrated debenture market are provided with high-quality and timely disclosure in relation to their investment.

82 In 2004, we initially conducted a review of the prospectus of nine debenture companies to assess whether debenture issues were fully informing investors of key investment risks. This review identified key disclosure deficiencies in a number of prospectuses.

83 We imposed a final stop order and three interim stop orders following the review. We also secured improved disclosure in two other cases and put a stop to misleading advertising in two cases: see Report 38 *High-yield debentures* (REP 38), issued in February 2005.

84 In August 2007, we issued Consultation Paper 89 *Unlisted, unrated debentures: Improving disclosure for retail investors* (CP 89). This paper set out our proposals to improve disclosure to retail investors to help them understand and assess debentures.

85 In October 2007, we released Regulatory Guide 69 *Debentures and notes: Improving disclosure for retail investors* (RG 69). This guide set out a series of disclosure benchmarks for the sector on an 'if not, why not' basis. It was designed to draw to the attention of investors key matters that they need to understand before deciding whether to invest in debentures. It also had the advantage of promoting the comparability of debentures.

86 After RG 69 was issued in October 2007, we visited each participant in the market and discussed the new regime. By March–April 2008, each ongoing issuer in the market reported under the new disclosure benchmarks to investors.

87 In April 2008, we issued Report 126 *Understanding investors in the unlisted, unrated debenture (UUD) market* (REP 126) and Report 127 *Debentures: Improving disclosure for retail investors* (REP 127). In October 2009, we issued Report 173 *Debentures: Second review of disclosure to investors* (REP 173). This report covered disclosure by issuers against the benchmarks between March 2008 and September 2009.

88 In October 2009, we issued Consultation Paper 123 *Debentures: Strengthening the disclosure benchmarks* (CP 123). This paper detailed our proposals for strengthening the disclosure benchmarks in RG 69. In June

2010, following the consultation, RG 69 was reissued. Further changes were made to the guide in February 2012.

Rollover exemption: s708(14)

89 We have also released guidance on the rollover exception in s708(14) of the Corporations Act. The rollover exception provides that a debenture issuer does not need to provide a prospectus to existing investors who make a decision to extend the maturity date of the initial investment (i.e. to roll over their investment) or to make a further debenture investment.

90 An issuer is required to prepare and lodge continuous disclosure notices with ASIC. These notices are meant to provide investors with up-to-date information that is material to their decision to continue to invest. However, under the law, an issuer is not required to publish these notices on their website or mail the updates to investors. Regulatory Guide 198 *Unlisted disclosing entities: Continuous disclosure obligations* (RG 198), issued in June 2009, facilitates the practice of issuers providing such disclosure on their website because this is often the most effective means of disclosing new material information to investors. In addition, our guidance on rollovers suggests that failure to alert investors to updated disclosure at the time of rolling over can amount to misleading conduct: RG 69.94.

Advertising

91 Concurrent with our guidance on prospectus disclosure, we have also provided guidance on advertising by debenture issuers. In December 2007, we issued Regulatory Guide 156 *Advertising of debentures and notes to retail investors* (RG 156). This guide was revised and reissued in June 2010 and February 2012. We expect issuers advertising debentures to ensure that their advertisements for debentures confirm that the product is not a bank deposit and that there is a risk that investors could lose some or all of their money. We are continuing with our review of advertising in the market and will be engaging with issuers where we have concerns.

Investor education

92 We have also focused on endeavouring to educate investors about debenture products. Relevant material on our MoneySmart website includes:

(a) ‘Investments paying interest’;

(b) ‘Unlisted debentures, secured and unsecured notes’; and

(c) a detailed guide explaining the benchmarks, *Investing in unlisted debentures and unsecured notes? Independent guide for investors reading a prospectus for unlisted debentures or unsecured notes*.

93 From time to time, we have raised concerns through our media releases. For example, on 8 February 2012, in the context of our ongoing work and the continuous disclosure regime, we issued Media Release (12-18MR) *ASIC warns about secured debt products.*

Monitoring the sector and its participants

94 In addition to reviewing the disclosure lodged with us and taking action where we have identified concerns with disclosure, we have regularly engaged in more active monitoring of the unlisted debenture sector from time to time. Currently, after a review of current data and intelligence concerning this sector, we are visiting a number of debenture issuers to ensure that they are providing up-to-date disclosure to the market. We are also considering issuers' resilience to market conditions at this time, and are engaging with trustees to ensure that they are actively monitoring issuers. This work is continuing.

Monitoring auditors

95 We have reviewed selected audits of unlisted debenture issuers. In some cases, we have noted deficiencies in key aspects of the audits conducted by other auditors relating to areas such as loan loss provisioning.

96 In particular, we found the following in some audits:

(a) *Professional scepticism*:

  (i) Auditors needed to exercise greater levels of professional scepticism when considering the impairment of loans receivable.

  (ii) Auditors did not obtain sufficient appropriate evidence to support their conclusion that loans were fairly stated.

  (iii) Auditors relied solely on the representations from management of the company about the adequacy of the security underpinning loans.

(b) *Other key aspects of audit quality*:

  (i) Auditors did not fully understand the company's business model and risks, and how these factors affected the nature and extent of audit work that was required.

  (ii) Directors needed to consider the level of fees that were paid to the auditor and whether they were commensurate with the extent of audit work that was required.

97 Our audit inspection program report for 2011–12 includes further findings about the need for greater professional scepticism, and examples of good practice for exercising professional scepticism. We will continue our focus on auditors for this market sector.

Key terms

Term	Meaning in this document
ADI	Authorised deposit-taking institution—has the meaning given in s9 of the Corporations Act
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
capital base	The funding sources to which an entity can most easily allocate losses without triggering insolvency. It means issued capital, reserves, retained earnings and non-redeemable preference shares, net of deductions
Ch 2L	A chapter of the Corporations Act (in this example, numbered 2L)
Corporations Act	*Corporations Act 2001*
deductions	Assets that have little or no value in an insolvency situation, such as goodwill, deferred tax assets and off-balance sheet assets
liabilities	Total on-balance sheet liabilities (including equity) and irrevocable commitments less the capital base
past due	For a financial asset, this is when a counterparty fails to make a payment when contractually due
retail debenture issuing lender	An entity (issuer) that borrows or has borrowed money from retail investors through the issue of debentures under a disclosure document where those funds are ultimately used: • in the course of carrying on a business that ordinarily involves providing finance or other advances of money to persons or entities outside the issuer's group; or • to fund (directly or indirectly) property lending, development and investments, and these funds in aggregate are more than 10% of the issuer's total assets. This term includes issuers that no longer have a current prospectus, but that have undertaken such borrowing in the past, and continue to have liabilities under that borrowing
retail investor	An investor who must be given a disclosure document for offers of debentures under Ch 6D of the Corporations Act
RG 69	An ASIC regulatory guide (in this example numbered 69)
risk-weighted assets	A measure of the entity's on-balance sheet assets, adjusted for risk. These are set out in detail at proposal B4

Term	Meaning in this document
rollover	Where an existing investor keeps their money in the existing debenture investment for an additional term (whether on the same or slightly different terms)
s708(14)	A section of the Corporations Act (in this example numbered 708(14)), unless otherwise specified

List of proposals and questions

Proposal	Your feedback
B1 We propose that mandatory capital and liquidity requirements should apply to an entity (issuer) that borrows or has borrowed money from retail investors through the issue of debentures under a disclosure document where those funds are ultimately used: (a) in the course of carrying on a business that ordinarily involves providing finance or other advances of money to persons or entities outside the issuer's group; or (b) to fund (directly or indirectly) property lending, development and investments and these funds in aggregate are more than 10% of the issuer's total assets. Note: In this consultation paper, we call these entities 'retail debenture issuing lenders'.	B1Q1 Do you consider that our proposed definition of 'retail debenture issuing lenders' appropriately describes debenture issuers who offer products that have similar characteristics to deposits offered by ADIs (but are not ADIs) and are engaged in lending? B1Q2 Do you think that our definition of 'retail debenture issuing lenders' is too wide or too narrow, and if so, why? Specifically, should limb (a) of our definition be narrowed to apply only to debenture issuers who provide finance or other advances of money to persons or entities outside the issuer's group for property -related lending, development or investment? B1Q3 Are there any other debenture issuers who should comply with the proposed capital and liquidity requirements but who would not come within our proposed definition? B1Q4 Are there any debenture issuers within the definition who should not be subject to our proposed capital and liquidity requirements? If so, please identify the type of issuers and why you do not think they should be subject to capital and liquidity requirements.
B2 We propose that retail debenture issuing lenders should be required to have a minimum capital ratio of 8% of their total risk-weighted assets, calculated as follows: $\text{Risk-based capital ratio} = \frac{\text{Capital base}}{\text{Total risk-weighted assets}}$ where: (a) *capital base* is defined as the funding sources to which an entity can most easily allocate losses without triggering insolvency. It means issued capital, reserves, retained earnings and non-redeemable preference shares, net of deductions; (b) *deductions* are defined as assets that have little or no value in an insolvency situation, such as goodwill, deferred tax assets and off-balance sheet assets; and (c) *risk-weighted assets* are defined as a measure of the entity's on-balance sheet assets, adjusted for risk. Risk weighting	B2Q1 Do you agree that retail debenture issuing lenders should be subject to minimum capital requirements? B2Q2 If so, is the proposed capital requirement of 8% of risk-weighted assets high enough to reflect industry risk and the fact that debenture issuers will not be subject to prudential supervision? B2Q3 Do you agree with the proposal for calculating the capital ratio (i.e. capital base minus deductions divided by total risk-weighted assets)? B2Q4 Do you agree with the proposed concept of 'capital base' and its inclusions? B2Q5 Do you agree with the proposed concept of 'deductions', which reduce the capital base? B2Q6 Are there any other obligations that should apply to an issuer to ensure that the calculations (e.g. of the issuer's assets) are appropriate and accurate? B2Q7 Should the fact that debenture holders may have a security interest over particular assets of the issuer be taken into account when

Proposal		Your feedback	
	adjusts the value of an asset for risk by multiplying it by a factor that reflects its risk. Low-risk assets are multiplied by a low number, and high-risk assets are multiplied by a higher number (100% or more in the case of assets that are very unlikely to be available to absorb losses). These are set out in detail at proposal B4.		imposing the proposed capital requirements and, if so, how?
		B2Q8	What changes to the operations of issuers will occur if these capital requirements are implemented?
		B2Q9	Will issuers have any practical difficulties in meeting and maintaining our minimum capital requirements? Please estimate the likely cost.
B3	We are proposing that there should be a discretionary power for ASIC to raise or lower the 8% minimum capital threshold on a case-by-case basis.	B3Q1	Do you agree that ASIC should be given this power? Why or why not?
		B3Q2	If there is a discretionary power, what kind of circumstances should be considered in deciding whether to raise or lower the capital requirement?
B4	We are proposing that debenture issuers' assets should be risk weighted, as set out in Table 2. If multiple categories apply to any particular investment, the highest risk weighting should be adopted.	B4Q1	Do you have any comments on our general approach to risk weighting assets?
		B4Q2	Do you consider that we have identified appropriate risk weightings for the different categories of assets?
		B4Q3	Are there other claims that should receive a higher risk weighting than 100% when they are more than 90 days overdue, impaired or non-accruing?
		B4Q4	Is there any common asset category that we have not identified? If so, what would be the appropriate risk weighting for that asset?
		B4Q5	Are there any other obligations (e.g. audit or other review requirements) that should apply to an issuer to ensure that the calculations (e.g. of the issuer's assets) are appropriate and accurate?
		B4Q6	What changes to the operations of issuers will occur if these capital requirements are implemented? Are there practical difficulties for issuers in maintaining the minimum capital requirement?
		B4Q7	Some of our risk weightings are conservative, given the absence of prudential supervision in the debenture sector. Do you agree with this approach?
		B4Q8	Do you consider that the risk weighting for assets that relate to property development activities is high enough? If not, how high should it be?
B5	We are proposing that retail debenture issuing lenders should maintain a minimum holding of 9% of their liabilities in high-quality liquid assets, where: (a) *liabilities* are defined as total on-balance sheet liabilities (including equity) and irrevocable commitments less the capital base;	B5Q1	Do you agree with the general concept that retail debenture issuing lenders should maintain a minimum holding of 9% of their liabilities in high-quality liquid assets at all times?
		B5Q2	Do you agree with the definitions of 'liabilities', 'capital base', 'deductions' and 'high-quality liquid assets'?

Proposal	Your feedback
(b) *capital base* is defined as the funding sources to which an entity can most easily allocate losses without triggering insolvency. It means issued capital reserves, retained earnings and non-redeemable preference shares, net of deductions; (c) *deductions* are defined as assets that have little or no value in an insolvency situation, such as goodwill, deferred tax assets and off-balance sheet assets; and (d) *high-quality liquid assets* are defined as unencumbered: (i) cash; (ii) money on deposit with an ADI (at call or readily convertible to cash within two business days); and (iii) marketable securities representing claims on or claims guaranteed by the Australian Government or the government of any Australian state or territory.	B5Q3 What changes to the operations of issuers will occur if these liquidity requirements are implemented? B5Q4 Will issuers have any practical difficulties in meeting and maintaining our proposed minimum liquidity requirements? Please estimate the likely cost.
B6 We consider that an issuer's obligation under Ch 2L of the Corporations Act to carry on and conduct its business in a proper and efficient manner would require it to monitor its capital and liquidity position against the proposed minimum requirements if these are implemented. We would expect an issuer to: (a) review its capital base, deductions, risk-weighted assets, liabilities and high-quality liquid assets on an ongoing basis to determine whether it meets the 8% capital requirement and the 9% liquidity requirement; (b) periodically make projections about its capital—for example, testing whether it could comply with the capital requirement if: (i) its business were to continue in accordance with past trends; or (ii) there were significant adverse impacts on the business (e.g. a portion of its loans had to be revalued); (c) appropriately update its asset values on an ongoing basis —for example: (i) loans secured by property should be revalued if the issuer becomes aware of a material change in the market value of property in an area or region; and (ii) construction or development loans should be valued on an 'as is' as well as an 'on completion' basis; and	B6Q1 Are our proposed monitoring requirements appropriate? If not, what other monitoring do you suggest? B6Q2 Please estimate any costs that issuers will incur in monitoring their capital and liquidity ratios? B6Q3 Do you agree that the obligation for the issuer to carry on and conduct its business in a fair and efficient manner is sufficient to ensure that issuers are required to monitor the capital and liquidity requirements? If not, what specific obligations should be imposed on issuers for monitoring these requirements? B6Q4 Should there be more explicit rules around valuations of assets applicable to retail debenture issuing lenders?

Proposal	Your feedback
(d) periodically 'stress test' its liquidity—for example, testing whether it could comply with the liquidity requirement: (i) if it was unable to raise new funds under a prospectus; (ii) if there was a withdrawal of an overdraft or other credit facility on which the issuer relies; and (iii) if there was a significant reduction of 5% or more in the rate of rollovers.	
B7 We propose that: (a) the law should require debenture trust deeds to contain the minimum capital and liquidity requirements proposed in this paper; (b) the law should require trustees to exercise reasonable diligence to ascertain whether the issuer has complied with the capital and liquidity requirements (either specifically or through the general requirement in s283DA(b)(ii) to monitor compliance with the trust deed); (c) the law should provide that issuers are only permitted to raise funds and roll over investments from retail investors if issuers comply with the capital and liquidity requirements at the time that the funds are accepted; and (d) the law should provide that issuers must immediately notify their trustee and ASIC if they no longer comply with the capital and liquidity requirements.	B7Q1 Do you agree that trustees should have responsibility for supervising debenture issuers' compliance with the minimum capital and liquidity requirements? B7Q2 What costs will this involve for trustees? B7Q3 Do you agree that issuers should not be able to raise further funds if they do not comply with the capital and liquidity requirements? Is the correct time to test this at the time that the funds are accepted, or another time? Why? B7Q4 Should a breach of capital and/or liquidity requirements automatically trigger an event of default power by the trustee, an automatic winding up of the company, court action by the trustee or ASIC, or some other action? If so, should any proposed trigger event be legislated or left as a matter for the trustee? B7Q5 To what extent should directors be held liable for a breach of capital or liquidity requirements? B7Q6 Do you think there should be any other consequences if the capital and liquidity requirements are not met? If so, please specify what consequences would be desirable.
B8 We are seeking feedback about whether further reforms are needed to strengthen the financial position of retail debenture issuing lenders.	B8Q1 Are there any other reforms that should be introduced to strengthen the financial position of retail debenture issuing lenders? B8Q2 Are there any additional requirements we should consider in relation to provisioning? B8Q3 Are there any additional requirements we should consider in relation to the non-accrual status of loans, or is this adequately dealt with under the accounting standards? B8Q4 What impact do you think the proposed standards would have on the structure of the retail debenture issuing lender sector and the number of entities in this sector?

Proposal	Your feedback
B9 We are proposing that liquidity requirements for retail debenture issuing lenders will come into effect four years after commencement of any new requirement. The capital requirements will be phased in over a four-year period, as follows: (a) 18 months following commencement: issuers need to hold 50% of the capital requirement (i.e. a capital ratio of 4% of risk-weighted assets); (b) three years following commencement: issuers need to hold 75% of the capital requirement (i.e. a capital ratio of 6% of risk-weighted assets); and (c) four years following commencement: issuers need to hold 100% of the capital requirement (i.e. a capital ratio of 8% of risk-weighted assets). Note: Once the minimum capital and liquidity requirements have come into effect, it is likely that we will make consequential changes to RG 69 for retail debenture issuing lenders (e.g. removing Benchmarks 1 and 2).	B9Q1 Do you consider the proposed transitional arrangements are appropriate? If not, what transitional arrangements would be adequate?
C1 We consider that s283DA of the Corporations Act implicitly requires a trustee to exercise reasonable diligence to regularly assess and form an opinion on an issuer's financial position, performance and viability. To clarify this requirement, we propose that the law should be amended to set out explicit obligations for trustees to exercise reasonable diligence to regularly assess and form an opinion on the issuer's financial position, performance and viability, including a critical review of provisioning arrangements. We propose that the assessment should be made at least quarterly and that there should be an explicit requirement for the trustee to provide a copy of their opinion to the issuer, any guarantor, and ASIC (but not to debenture holders. Note: Proposal C2 sets out some proposed guidance on what this duty would entail.	C1Q1 Will trustees have any practical issues with formally forming an opinion on the issuer's financial position, performance and viability? C1Q2 We are proposing that trustees should perform this assessment at least quarterly, and more often if the issuer's financial position requires more frequent monitoring. Is this frequency appropriate? If not, what frequency would be appropriate? C1Q3 Should trustees' reporting obligations be explicitly set out in legislation, or would you consider guidance to be more appropriate, and why. C1Q4 Do you consider that trustees should communicate their opinion to ASIC, the issuer and the issuer's auditor? C1Q5 We are not proposing that trustees should communicate their opinion on the issuer's financial position, performance and viability to debenture holders. Do you agree with this approach? C1Q6 Are trustees' current obligations sufficient to ensure that they are obliged to take appropriate action if the information they receive indicates concerns with the issuer's financial position, performance and viability?

Proposal	Your feedback
C2 If proposal C1 is implemented, we are proposing that the trustee's duty to assess an issuer's financial position, performance and viability would include: (a) that the trustee should asses the issuer's compliance with relevant financial services laws, including ASIC guidance about these laws; and (b) for retail debenture issuing lenders, that the trustee would exercise reasonable diligence in assessing: (i) the extent of arrears relative to key financial indicators (e.g. net assets, total loan book value, and any provision or reserve); (ii) the extent of non-performing loans or mortgagee in possession of assets and whether they are being realised in a prudent and timely way; (iii) indicators of impairment; (iv) dated valuations of underlying security; and (v) the amount of interest being paid or accrued to debenture holders or financiers relative to interest funds being received from the issuer's borrowers.	C2Q1 Do you consider that trustees will benefit from some specific indication in the law, or through guidance, about what is involved in assessing the issuer's financial position, performance and viability (proposal C1)? C2Q2 Do you agree with proposal C2 (i.e. our indication of what the trustee's duty to assess the issuer's financial position, performance and viability would involve)? If not, what do you consider that regularly assessing an issuer's financial position, performance and viability would involve?
C3 We propose that the law should be amended so that trustees have an obligation to exercise reasonable diligence to ensure that material information provided by the issuer in its prospectus is correct and current. Debenture issuers would be required to provide reasonable assistance to trustees to undertake this role: see proposal C5. The prospectus would include a statement to the effect that the trustee has undertaken this exercise.	C3Q1 Do you consider that requiring trustees to exercise reasonable diligence to ensure that material information in the issuer's prospectus is correct and current will help retail investors make informed investment decisions? C3Q2 Will the proposed obligation be onerous for trustees? Please estimate the likely cost. C3Q3 Should the legislation provide that trustees have a defence to liability if the material information is not correct and current? If so, should it be modelled on Ch 6D defences of reasonable diligence and reasonable reliance? C3Q4 Will trustees have sufficient powers and access to information to carry out this role (taking into account our other proposals at C5–C7)?

Proposal	Your feedback
C4 We propose that trustees should have an obligation to monitor whether the debenture issuer has adequate resources (including financial, technological and human resources) to meet the terms of the debentures, the provisions of the trust deed and the law.	C4Q1 Do you agree that the law should require trustees to monitor whether the issuer has adequate resources to meet their obligations to debenture holders? C4Q2 Should the law or guidance specify what adequate resources are required for different businesses, or is this better assessed by the trustee on a case-by-case basis? C4Q3 Should the debenture issuer be required to demonstrate to the trustee on a regular basis that its management, including directors, has sufficient experience and skills to manage the issuer's business? C4Q4 Should the law or guidance prescribe the types of experience, skills and qualifications held by the issuer's key personnel (e.g. directors)? C4Q5 Do any additional obligations need to be imposed on the issuer to have adequate resources, or is the obligation in s283BB(a) sufficient?
C5 We propose that the law should be amended so that a trustee has express powers to obtain information from the debenture issuer to supplement and give full effect to the issuer's current obligation to provide information under Ch 2L. Under this proposal, the trustee would have the right to: (a) require the issuer to provide, as soon as is reasonably practicable, information to the trustee about the issuer's financial position and business; (b) access the issuer's business, premises and records; (c) ask questions of the issuer's board and management; and (d) require the issuer to appoint an expert or other professional nominated by the trustee to prepare any report, analysis or advice for the trustee at the issuer's expense. For example, the trustee may require the issuer to obtain a valuation of the issuer's assets by a valuer nominated by the trustee, and then provide that valuation to the trustee. The trustee may also require the issuer to appoint an investigating accountant to prepare a report for the trustee on the issuer's financial position, performance and viability.	C5Q1 What limitations, if any, should there be on the type of information that the trustee can request? Please estimate the likely cost for issuers. C5Q2 Do you agree that the debenture issuer should provide information to the trustee within a reasonable period of time? C5Q3 It has been suggested that trustees should have a role in the appointment of the issuer's auditor. Do you agree? For example, should the trustee have the power to veto new appointments? If so, should this power only apply in the case of retail debenture issuing lenders?

Proposal		Your feedback	
C6	We are proposing that proposals C1–C5 should apply to the retail debenture sector broadly—that is, to entities that issue debentures, whether or not they are listed and whether or not the issuer on-lends.	C6Q1	Do you agree with the application of the proposals?
		C6Q2	If not, what do you recommend and why?
C7	We are proposing that the amendments in C1–C5 should have a limited transition period of 12 months (i.e. they take effect no later than 12 months after commencement).	C7Q1	Do you agree that the proposed amendments to the trustee's role and powers should have a transition period of 12 months? If not, what transition period do you recommend and why?
D1	We propose that the law should be amended so that debenture issuers must engage their auditor to report directly to the trustee twice per year and answer any reasonable questions the trustee asks. The reports provided would be the audited annual report and reviewed half-yearly report. In addition, we propose that the obligation in s313(2) to report to the debenture issuer on any matters that come to the auditor's attention that are likely to be prejudicial to debenture holders or relevant to the exercise of the trustee's powers should be expanded to require that this report should also be given directly to the trustee.	D1Q1	Do you agree that the auditor should be required to directly report to and communicate with the trustee? Will this help trustees to better exercise their powers and perform their duties?
		D1Q2	Will this proposal better focus the auditor's attention on the role the auditor plays in relation to the debenture holders?
		D1Q3	In addition to the current obligations under the Corporations Act, are there any further matters on which the auditor should be obliged to report?
		D1Q4	Please estimate the likely cost of this proposal for issuers, trustees and auditors (in particular, the auditor being required to answer any questions the trustee asks). Do you consider that the proposal would be cost-effective?
		D1Q5	Do you think that auditors should have any positive obligations to make inquiries or produce reports, other than those currently required under the Corporations Act or proposed above?
D2	We are proposing that the requirement for auditors to report directly to the trustee and to answer any reasonable questions of the trustee should apply to the debenture sector generally.	D2Q1	Do you agree that this requirement should apply to the debenture sector generally, or should it only apply to retail debenture issuing lenders?
D3	We propose that the requirement for the auditor to report directly to the trustee and to answer the trustee's reasonable questions should come into effect after a transition period of 12 months.	D3Q1	Do you agree that a transition period of 12 months after the next end of financial year will be sufficient? If not, what transition period would be appropriate?

Proposal		Your feedback	
E1	We propose that s708(14) of the Corporations Act should be amended so that retail debenture issuing lenders are required to provide a prospectus when existing retail investors make further debenture investments or roll over their debenture investments.	E1Q1	Do you agree that retail investors need a prospectus before deciding whether or not to leave their funds invested or make a further investment with a retail debenture issuing lender? If not, would a reduced form of disclosure be appropriate?
		E1Q2	We are proposing that only retail debenture issuing lenders should be required to give a prospectus to existing retail investors. Do you consider this proposal should apply to all debenture issuers?
		E1Q3	Will this requirement be onerous for debenture issuers? If so, please estimate the likely cost.
		E1Q4	Should investors have to take some action to roll over their debenture investments (rather than rollovers happening automatically if they do not take action)?
		E1Q5	Regulatory Guide 198 *Unlisted disclosing entities: Continuous disclosure obligations* (RG 198) recommends and facilitates unlisted debenture issuers putting their continuous disclosure notices on their website (as a matter of good practice). Should this be a legal requirement for retail debenture issuing lenders? Should this obligation apply more broadly to all debenture issuers?
E2	We propose that the amendment to s708(14) in proposal E1 would take effect 12 months after the amendment is made.	E2Q1	Do you agree with this 12-month transition period for the proposed amendment to s708(14)? If not, what transition period do you recommend and why?