



ASIC

Australian Securities & Investments Commission

REPORT 196

Response to submissions on CP 126 Facilitating debt raising

May 2010

About this report

This report highlights the key issues that arose out of the submissions received in response to Consultation Paper 126 *Facilitating debt raising* (CP 126) and details our responses to those issues.

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.

Disclaimer

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

This report does not contain ASIC policy. Please see Regulatory Guide 213 *Facilitating debt raising* (RG 213).

Contents

A	Overview/consultation process	4
B	Vanilla bonds prospectus relief	6
	Overview of proposals	6
	Overview of submissions	7
C	Two-part prospectus relief.....	12
	Relief to extend [CO 00/173]	12
	General two-part vanilla bonds prospectus relief	13
D	Disclosure relief for offers of convertible notes to institutional investors.....	15
	Institutional offers of convertible notes	15
E	Review of annual reporting disclosure	17
	Appendix: List of non-confidential respondents	18

A Overview/consultation process

- 1 In Consultation Paper 126 *Facilitating debt raising* (CP 126), we consulted on relief to facilitate certain offers of ‘vanilla’ corporate bonds.
- 2 We proposed to grant relief from the fundraising provisions in Ch 6D of the *Corporations Act 2001* (Corporations Act) to facilitate efficient corporate bond raisings by listed entities, provided that investor protection was not unduly compromised. We proposed relief to allow a listed entity to offer vanilla bonds using a simplified prospectus (‘vanilla bonds prospectus’) with a similar level of content to a transaction-specific prospectus.
- 3 We proposed that our relief would only apply if various conditions were satisfied, relating to:
 - (a) the bonds—relief would only apply to vanilla bonds that would be quoted on issue and if the issue was for a total of at least \$100 million;
 - (b) the issuer—the issuer must be entitled to use a transaction-specific prospectus for an offer of continuously quoted securities, and the most recent financial statements of the issuer must be unmodified; and
 - (c) disclosure—point-of-sale disclosure must be provided for various matters (including key financial disclosures). Ongoing disclosure must also be provided for certain matters (including quarterly updates of key financial disclosures and the quarterly reports required under s283BF).
- 4 We also proposed relief to allow a vanilla bonds prospectus to be in two parts, comprising:
 - (a) a base prospectus, which could be used for several different offers; and
 - (b) a second part prospectus, which would relate to a particular offer.
- 5 Finally, we consulted on providing relief in relation to offers of convertible notes to wholesale investors. In practice, these offers require a prospectus so that the underlying quoted securities can be on-sold to retail investors. We proposed relief so that the underlying quoted securities can be on-sold without a prospectus if a cleansing notice containing prospectus-like disclosure is provided to the relevant market operator at the time the convertible notes are issued.
- 6 In addition to the relief proposed, we also sought views on how well the annual reporting regime is operating and whether annual reports could become a more effective source of information for investors. The relief proposed also sought to improve annual reports published by issuers relying on the relief by requiring that their future annual reports include updates of key information.

- 7 The proposals were designed to remove various regulatory impediments to debt raisings and also to increase the opportunities for retail investors to invest directly in quoted corporate bonds, while still maintaining market integrity and investor protection.
- 8 This report highlights the key issues that arose out of the submissions received in response to CP 126 and our responses to those issues.
- 9 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 126. We have limited this report to the key issues.

Responses to consultation

- 10 We received 31 responses to CP 126 from a wide variety of sources, including relevant industry bodies, industry participants, law firms and stock exchanges. We are grateful to respondents for taking the time to send us their comments.
- 11 For a list of the non-confidential respondents to CP 126, see the Appendix. Copies of the non-confidential submissions are on the ASIC website at www.asic.gov.au/cp under CP 126.
- 12 There was general support for our proposals to facilitate corporate bond raisings and offers of convertible notes (although respondents raised certain matters of detail). We have therefore decided to proceed to implement those proposals, although not in all cases on the exact terms proposed in CP 126. For more detail, see the remainder of this report.

B Vanilla bonds prospectus relief

Key points

Should we grant class order relief to allow offers of vanilla bonds to be made using a vanilla bonds prospectus?

What conditions should apply to any class order relief?

Overview of proposals

- 13 In CP 126 we invited submissions on whether we should provide relief permitting an issuer to use a simplified prospectus (known as a vanilla bonds prospectus) for an offer of vanilla bonds provided that certain conditions were satisfied relating to the bond issuer, the type of bonds offered and disclosure regarding those bonds.
- 14 We proposed that an issuer would only be able to use a vanilla bonds prospectus if the following conditions were met relating to the bonds:
- (a) the bonds were vanilla bonds that would be quoted when issued—it was proposed that bonds would be ‘vanilla’ if they: were denominated in Australian dollars; had a fixed term of no more than 10 years; had a fixed or floating rate of return that comprises a variable market determined rate plus a fixed margin; provided for interest to be paid periodically on the dates specified in the prospectus; ranked at least equally with unsecured and unsubordinated creditors; were not convertible into other securities; and were issued to all investors at the same price;
 - (b) the aggregate size of the bond issue would be at least \$100 million;
 - (c) the bonds would be governed by a trust deed that required the bond issuer to update the key financial disclosures contained in the vanilla bonds prospectus on a quarterly basis and to provide these updates, together with the quarterly reports required under s283BF, to ASX and to include them on the issuer’s website.
- 15 We proposed that an issuer must satisfy certain conditions in order to be able to rely on the relief, including that the issuer be entitled to use a transaction-specific prospectus for an offer of continuously quoted securities and that the most recent financial statements of the issuer be unmodified.
- 16 We also proposed that a vanilla bonds prospectus would be required to contain disclosure on the following matters, as identified in Appendix 1 to CP 126:

- (a) the key features, risks and benefits of the bonds;
- (b) the following key financial disclosures:
 - (i) details of any debt ranking ahead of the bonds;
 - (ii) whether the issuer is in breach of any loan covenants or has defaulted on previous debt obligations;
 - (iii) the gearing ratio, the interest cover and the working capital ratio, determined as specified in Appendix 2 to CP 126;
- (c) a commitment to update these financial disclosures on a quarterly basis and provide these updates, together with the quarterly reports required under s283BF, to ASX and to include them on the issuer's website;
- (d) a statement that all information of the type referred to in s713(5)(b) has been disclosed to the market or is in the prospectus (to the extent that it is reasonable to find that information in a prospectus);
- (e) disclosure of any other information that would be required under a transaction-specific prospectus if the corporate bonds were continuously quoted securities;
- (f) a facility allowing investors to receive email notification when new ongoing information is published; and
- (g) a statement that ASIC has published an investor guide for retail investors who are considering investing in corporate bonds and that a copy of the guide is available from ASIC free of charge.

Overview of submissions

- 17 The majority of respondents were in favour of the relief (subject to certain suggested changes), and noted that relief would benefit issuers by lowering costs and increasing speed to market. Some mentioned, however, the risk that relief may be underutilised due to the competitiveness of other debt funding sources, and the disclosure and directors' liability requirements associated with the prospectus regime. Respondents also noted the associated benefits available to retail investors, including greater access for retail investors to bond issues and a greater ability to diversify investment portfolios.

ASIC's response

We have provided disclosure relief for offers of vanilla bonds in [CO 10/321]. The relief is broadly along the lines proposed in CP 126, although we have made some changes in response to submissions. These changes are discussed below.

Conditions relating to bonds

- 18 Submissions generally supported the majority of our proposed conditions in relation to vanilla bonds. However, a number of respondents considered that subordinated bonds should be able to qualify as vanilla bonds, particularly if they were issued by entities regulated by the Australian Prudential Regulation Authority (APRA) for regulatory capital purposes. These submissions stated that subordination could be dealt with through disclosure, rather than being a feature that should preclude reliance on the relief.
- 19 Respondents were divided on the appropriate level of minimum subscription for vanilla bond issues, with some suggesting that at least \$100 million would be necessary in order to provide sufficient liquidity in the secondary market. Others considered that the level should be no higher than \$50 million in order to promote participation by smaller entities (who might otherwise be disqualified by the proposed \$100 million minimum).
- 20 Submissions generally opposed any restriction on the ability of issuers to issue debt that ranked ahead of debt issued under a vanilla bonds prospectus, as doing so would reduce the issuer's funding flexibility. Some respondents also stated that the terms of the vanilla bonds should permit interest deferral or step-up rights in certain circumstances (particularly for issues by APRA-regulated entities). Almost all submissions agreed that early redemption of vanilla bonds should be permitted in certain circumstances, such as where the issuer encounters an adverse tax event or is subject to a change of control.

ASIC's response

We have reduced the minimum subscription size from \$100 million to \$50 million in order to make our relief available to a greater range of issuers. The minimum subscription requirement will lapse after two years (unless we renew it) and we will review it prior to that time in light of how our relief is operating.

Our relief allows vanilla bonds to be redeemed early in certain common circumstances, such as a change in control or an adverse tax event. We will consider other early redemption events on a case-by-case basis.

Our relief does not currently extend to offers of subordinated bonds. The retail debt market is not well developed and could be adversely impacted if an issuer defaulted on payments of interest or capital. Subordinated bonds carry a greater risk of a capital loss or a failure to meet interest payments than senior debt.

We intend to review how our relief is operating and, in light of that information, consult further within the next 12 months on whether relief should extend to offers of subordinated bonds (including offers of subordinated bonds by APRA-regulated entities for regulatory capital purposes).

Although our relief does not currently facilitate offers of subordinated bonds by APRA-regulated entities, we note that authorised deposit taking institutions (ADIs) and life insurers are able to take advantage of the prospectus exemption in s708(19) when offering corporate bonds. Vanilla bonds prospectus relief would only be relevant to general insurers and those APRA-regulated entities that wished to offer bonds through a subsidiary.

Our relief does not prevent issuers from issuing debt ranking ahead of bonds issued under a vanilla bonds prospectus. Such a requirement might unnecessarily impinge on a company's funding flexibility and reduce the attractiveness of the relief. We may seek further submissions on this point when we consult on offers of subordinated bonds in the next 12 months.

Conditions relating to issuers

- 21 A number of respondents submitted that relief should be extended to foreign issuers, although others noted the difficulty for Australian investors in accessing information on a foreign exchange and stated that it would be critical for any bonds that were issued to be quoted on a local Australian exchange. Some respondents submitted that the proposed relief should be extended so that wholly owned subsidiaries of listed entities could rely on the relief.
- 22 Respondents did not consider that a minimum amount of net tangible assets should be required for issuers to be entitled to use a vanilla bonds prospectus. There was also significant opposition to the imposition of a requirement that issuers be required to satisfy minimum conditions based on key financial metrics. Respondents noted that an appropriate net tangible asset level and appropriate minimum financial metrics would vary across industries and issuers.

ASIC's response

We have not required issuers to demonstrate a minimum level of net tangible assets or satisfy minimum financial metrics in order to rely on the relief. Given differences between issuers and the industries in which they operate, it is not possible to prescribe a relevant minimum level of net tangible assets or minimum financial metrics.

Our relief does not extend to foreign issuers that are listed on a foreign exchange. Foreign continuous disclosure requirements are not strictly equivalent to Australian continuous disclosure requirements and information on a foreign exchange will be more difficult for Australian investors to access than information on an Australian exchange.

We may consider case-by-case relief for offers of vanilla bonds by wholly owned subsidiaries of listed entities. Relief would be conditional on:

- investors receiving the same level of disclosure as if the bonds had been issued by the listed parent; and
- the risks of investing in the bonds being comparable to the risks that would be faced if the bonds had been issued by the listed parent.

Disclosure conditions

- 23 A number of respondents submitted that the proposed key financial metrics may not be able to be compared across industries and that investors may not understand the metrics. Other respondents noted that the metrics were commonly used and appropriate.
- 24 Some respondents did not agree that quarterly updating of the metrics was appropriate in light of an issuer's continuous disclosure obligations, and noted that equity issuers only have to disclose matters of this nature semi-annually. Other respondents considered that compliance with the quarterly reporting requirements under s283BF in combination with an issuer's continuous disclosure obligations would be a sufficient level of disclosure.
- 25 Some respondents also believed that requiring issuers to comply with the s283BF obligations on a quarterly basis was also too onerous. Those in support noted that s283BF reports contained a comprehensive list of disclosures.

ASIC's response

Issuers taking advantage of our relief will need to provide up-front and ongoing disclosure of key financial metrics. Consumer testing undertaken by us supported the disclosure of key metrics to retail investors. We think the metrics will provide useful information for investors, particularly when investors compare issuers in the same industry or where investors wish to assess an individual issuer's metrics over a period of time.

Issuers who consider that the metrics do not adequately take account of their particular circumstances will be able to disclose why this is the case or provide additional metrics that they consider are appropriate to their circumstances.

We agree that it may be burdensome to update key financial metrics on a quarterly basis and instead have required disclosure semi-annually (based on annual or half-year financial statements). Issuers will be required to give investors the option of receiving email notification of all continuous disclosure notices published by the issuer on ASX.

We consider that the information in quarterly reports under s283BF will be useful for retail investors and have maintained the requirement for quarterly reports to be published on ASX and the issuer's website. However, the versions of the reports provided to ASX and included on the issuer's website need only include the matters referred to in s283BF(4)(a) and (b)(iii) to the extent that they are material to bondholders.

Other matters

- 26 The majority of submissions agreed that we should not give relief from either the exposure period requirements or the debenture trustee requirements for a vanilla bonds prospectus.
- 27 A number of respondents submitted that rather than requiring issuers to satisfy financial metrics in order to rely on the relief, we should impose a requirement that the bonds have an investment-grade credit rating. Some submissions considered that a credit rating is a better assessment of the creditworthiness than the financial metrics proposed.

ASIC's response

We have not provided general relief from the exposure period requirement for offers of vanilla bonds. However, we have provided exposure period relief where the bonds being offered only differ as to term, interest rate and interest payment dates from existing quoted bonds: see [CO 10/321].

As suggested in one submission, we have granted some minor relief from the quarterly reporting requirements for vanilla bonds by modifying s283BF(4)(c) and (d) so that their disclosure requirements only apply to the issuer and any guarantor.

We have not required that corporate bonds must have an investment-grade credit rating in order for issuers to be able to rely on our relief. There is currently no credit rating agency with an Australian financial services licence that covers the provision of credit ratings to retail investors. Accordingly, if our relief required a credit rating to be obtained and provided to retail investors, it could not be used.

C Two-part prospectus relief

Key points

Should we provide relief to facilitate a two-part prospectus approach for offers of vanilla bonds?

- 28 In CP 126 we sought feedback on whether we should provide relief to facilitate a two-part prospectus approach for offers of vanilla bonds in Australia. We proposed two potential ways in which this could be done:
- (a) extending the operation of Class Order [CO 00/173] *Debenture prospectuses: Incorporation of information on application forms* so that it applies to listed entities that are entitled to use a vanilla bonds prospectus, but do not issue debentures in the ordinary course of their business; and
 - (b) granting relief allowing an issuer that is entitled to use a vanilla bonds prospectus to offer vanilla bonds under a two-part prospectus, comprising:
 - (i) a base prospectus, which could be used for a number of offers of vanilla bonds; and
 - (ii) a second part prospectus, which would relate to a specific offer of bonds so that the base prospectus and the second part prospectus would collectively contain all the information required to be disclosed in a vanilla bonds prospectus.

Relief to extend [CO 00/173]

- 29 [CO 00/173] enables entities that issue debentures in the ordinary course of their business to adopt a limited two-part prospectus approach. The class order allows a prospectus for an offer of debentures not to include interest rate and term information, where the prospectus is accompanied by the most recent application form containing this information that has been lodged with ASIC.
- 30 A slight majority of submissions supported extending [CO 00/173] to apply to issuers of vanilla bonds. These respondents noted that extending [CO 00/173] in this way would benefit issuers by reducing costs, simplifying and streamlining the raising of debt finance, and increasing flexibility for bond issuers in terms of issue price and terms of bonds.
- 31 Submissions against this proposal noted that extending [CO 00/173] may not be useful for issuers of corporate bonds, as (unlike debenture issuers) they

raise money periodically, rather than continuously, and do so from different funding sources.

ASIC's response

Given that we will be providing general two-part vanilla bonds prospectus relief (see below), we will not be extending the operation of [CO 00/173], which is more limited in its scope.

General two-part vanilla bonds prospectus relief

- 32 There was a significant level of support for our proposed two-part prospectus relief. Respondents noted that this would provide greater flexibility to issuers, while not diminishing investor protections, and that this aspect of the proposed relief was the key to building depth in the market and reducing transaction costs. It was remarked that this relief would provide medium-term cost benefits for issuers that could justify the establishment of retail debt programs.
- 33 In terms of the division of information between the base and second part prospectus, submissions generally noted that the base prospectus would contain all the non-variable information relating to the issuer and the bonds, as well as the issuer's latest reported financial statements. It was also submitted that the base prospectus would include the benefits and risks of investing in the bonds, as well as the general features of the bonds (e.g. security, ranking, terms). A number of respondents also submitted that the maximum life of a base prospectus should be at least two years (as opposed to the current maximum of 13 months).
- 34 Submissions considered that the second part prospectus would contain all of the 'variable' information relating to an offer of bonds (e.g. issue price, interest rate, amount to be issued, maturity of the bonds and timetable of the issue). The majority of submissions were in favour of ASIC granting exposure period relief in relation to the second part prospectus.

ASIC's response

We have granted relief in [CO 10/321] to facilitate the use of a two-part prospectus for offers of vanilla bonds. We have not been prescriptive about the division of information between the base and second part prospectus. However, the two documents must collectively meet the content requirements for a vanilla bonds prospectus and must be clear, concise and effective.

In practice, we expect that most of the 'fixed' information regarding an issuer and the bonds would generally be contained in the base prospectus, with the 'variable' information generally being included in the second part prospectus. For example, the second part prospectus might include matters such as the proposed issue price, the size of the issue, the maturity of the bonds and the effect of the issue on the issuer (including the effect of the issue on the issuer's key financial metrics).

We have provided relief to allow the maximum life for a base prospectus to be two years. That is because two-part prospectus relief is intended to facilitate multiple issues of securities off a base prospectus and may be less likely to assist issuers if the maximum life of a base prospectus is only 13 months. The maximum life of a second part prospectus is limited to 13 months.

We have not provided general exposure period relief for a two-part prospectus. The exposure period will commence on the date that the second part prospectus is lodged with ASIC, rather than on lodgement of the base prospectus. That is because the details of the offer will only be known after both the base prospectus and the second part prospectus have been lodged. However, [CO 10/321] provides exposure period relief if vanilla bonds offered under a two-part prospectus or under a vanilla bonds prospectus differ only as to term, interest rate and interest payment dates from existing quoted bonds.

D Disclosure relief for offers of convertible notes to institutional investors

Key points

Should we grant class order relief from the on-sale provisions for the on-sale of underlying quoted securities issued on the conversion of convertible notes?

Institutional offers of convertible notes

- 35 Although a prospectus is not strictly required for an offer of convertible notes to institutional investors, in practice a transaction-specific prospectus will often be necessary to allow the underlying quoted securities to be on-sold to retail investors. The need to prepare a transaction-specific prospectus may act as an impediment to entities that wish to raise funds by issuing convertible notes to institutional investors.
- 36 In CP 126 we asked whether we should grant class order relief from the requirement to prepare a transaction-specific prospectus for an institutional offer of convertible notes. Relief would require issuers to lodge a cleansing notice that contained prospectus-like disclosure in relation to the convertible notes and underlying securities. A proposed condition of the relief involved enhanced annual reporting disclosure relating to the notes.
- 37 The responses were generally in favour of granting relief and strongly supported the relief being implemented in the form of a class order. One reason for this is that there are a range of people who are potentially liable for a prospectus, not just the issuer: s729. This can make due diligence more involved than would be the case for an information memorandum prepared for institutional investors. Some submissions commented that relief should also apply to notes that convert into units and stapled securities.
- 38 Some submissions disagreed with the proposed condition to require prospectus-like disclosure in a cleansing statement. Other responses considered the cleansing notice should only contain details of the underlying securities and not the convertible notes themselves.
- 39 Some responses also disagreed with the proposed condition to require the annual report to contain ongoing information relating to the notes, noting that the issuer will be subject to ongoing continuous disclosure obligations.

ASIC's response

We consider granting relief in the form of a class order is appropriate. This relief is contained in [CO 10/322] and should benefit issuers, including by simplifying the due diligence process involved in offers of convertible notes. Our relief covers notes that convert into quoted shares, units and stapled securities.

Our relief is conditional on the cleansing notice containing prospectus-level disclosure in relation to the convertible notes and underlying securities. We consider that this information will be relevant to security holders.

Our relief is subject to a requirement to disclose certain key information in annual reports during the term of the convertible notes. We consider this ongoing disclosure requirement is not overly burdensome and will benefit investors. However, we have made some minor changes to address some of the concerns raised regarding the level of disclosure required. In particular, consistent with s299A(3), we have specified that the annual report may omit certain information if it is likely to result in unreasonable prejudice to the issuer.

E Review of annual reporting disclosure

Key points

How effective are annual reports as an information source for investors? Is there scope to improve them by enhancing the level of information they currently provide?

- 40 In CP 126 we invited submissions on how useful the annual reporting regime was as a source of information for investors in corporate bonds and other quoted securities. We also asked whether annual reports could be improved.
- 41 The responses we received generally agreed that annual reports are a valuable information resource for investors. Some submissions considered that the existing annual reporting requirements were satisfactory and should not be expanded unless there was a strong case to do so. Other respondents submitted that annual reporting requirements should only be considered as part of a broader project which focused on all classes of security holders.
- 42 Some submissions considered that annual reports could be improved. For example, submissions recommended the annual report be aligned with more investor-driven documents, such as profit announcements, or include narrative reporting in the form of directors' discussion and analysis. One submission noted that retrospective information and overly broad forecasts in annual reports did not assist investors, while another submission considered the general length and proliferation of jargon in annual reports was a problem. We also received submissions identifying specific information relating to corporate bonds that could be included in the annual report.

ASIC's response

We appreciated all feedback on annual reporting disclosures. We propose to further monitor the operation of the annual reporting regime, including in light of this information.

Our relief is subject to conditions that seek to enhance reporting to investors. The relief in [CO 10/322] requires disclosure in annual reports of key matters relating to convertible notes, while the relief in [CO 10/321] requires issuers to publish annual and half-year reports containing key financial disclosures.

Appendix: List of non-confidential respondents

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1. Abacus – Australian Mutuals
 2. ADCM Services
 3. Allens Arthur Robinson
 4. AquAsia
 5. Australasian Investor Relations Association
 6. Australian Accounting Standards Board
 7. Australian Bankers' Association
 8. Australian Financial Markets Association
 9. Australian Securities Exchange
 10. Colonial First State Global Asset Management
 11. FIIG Securities
 12. Finance & Treasury Association
 13. Financial Services Institute of Australasia
 14. Freehills
 15. Group of 100
 16. Law Council of Australia
 17. Morgan Stanley Smith Barney Australia
 18. Morningstar
 19. Property Council of Australia
 20. Stockbrokers Association of Australia
 21. Telstra
 22. Trust Company
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