REPORT 108

Report on submissions for CP 89 Unlisted, unrated debentures

October 2007

About this report

This report highlights the key issues that arose out of the submissions received to Consultation Paper 89 *Unlisted, unrated debentures—improving disclosure for retail investors* (CP 89) and details our responses in relation to those issues.

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- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
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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 69 *Debentures—improving disclosure for retail investors* (RG 69) and Consultation Paper 94 *Debenture advertising* (CP 94).

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A Overview/Consultation process

1 In Consultation Paper 89 *Unlisted, unrated debentures—improving disclosure for retail investors* (CP 89), we consulted on proposals to improve disclosure to retail investors in the unlisted and unrated debenture market.

2 The improved disclosure measures consulted on were based on 'if not, why not' reporting. That is, issuers would report to investors against certain principles and benchmarks, which they should follow or explain how and why they may not have followed those principles and benchmarks.

3 This report highlights the key issues that arose out of the submissions received to CP 89 and our responses to those issues.

4 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 89. We have limited this report to the key issues.

5 For a list of the non-confidential respondents to CP 89, see Appendix 1. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp under CP 89.

Responses to consultation

6 We received around 60 responses to CP 89 from a wide variety of sources including a range of consultants, debenture issuers (both large and small), relevant industry bodies, consumer groups, consumers, legal bodies and law firms, stock exchanges, ratings providers and educators. We are grateful to respondents for taking the time to send us their comments.

7 There was widespread support for ASIC to improve retail investor protection in the area of unlisted, unrated debentures. We have therefore decided to proceed with implementing an improved disclosure regime in this area based on a series of benchmarks and the 'if not, why not' principles.

8 The main issues raised by respondents related to:

- the scope of the regime and who would be subject to it;
- the benchmarks and how they should apply;
- issues associated with advertising;
- issues associated with trustees; and
- the timing of the changes.

B Scope—Who should be subject to the regime?

Key points

- Should the scope of the regime be confined to real property or property-related debentures? (See paragraph 9)
- Should we exempt issuers from the scope of the regime if the debentures are rated or listed? (See paragraphs 10–14)
- Should we exempt any entities from the regime based on their activities or use of funds? (See paragraphs 15–17)

Should it be confined to property-related debentures?

9 Some feedback suggested that the new regime should be confined to real property or property-related debentures because the major debenture failures in Australia have occurred where property development is involved.

ASIC's response

To date failures in Australia have been limited to situations where property development was involved. However, some of the recent collapses elsewhere (e.g. in New Zealand) have been of issuers of non property-related debentures.

We also feel that risks inherent to many other types of debenture issuers are similar (albeit not identical) to the risks with property-related issuers. Historically, finance companies beyond the property development sector have suffered financial difficulty from time to time in adverse economic conditions. Therefore, we believe that an enhanced disclosure regime is appropriate for debenture schemes more generally.

While we acknowledge that practical issues may arise with the application of benchmarks in relation to some business models, these are more appropriately dealt with by individually tailoring the benchmarks to take these issues into consideration.

We therefore do not feel that the regime should be confined to real property or property development related debentures.

Should issuers be excluded if their debentures are rated or listed?

Rated debentures

10 Some respondents felt that if debentures are rated, the issuer should no longer be subject to the benchmark disclosures (in relation to those debentures).

11 Others felt that in the interests of a level playing field, merely obtaining a credit rating should not excuse an issuer from having to comply with the other benchmark obligations.

12 Credit rating agencies that responded to CP 89 were also opposed to removing the requirement to comply with the other benchmarks once a rating is acquired. They felt excluding rated debentures places undue weight on the credit rating to inform consumers about the risks inherent in these products.

> *ASIC's response*
>
> We agree that a credit rating cannot be relied upon to provide all necessary information about a debenture or the issuer and the new enhanced disclosures against the benchmarks will provide investors with succinct disclosure about a range of important indicators of the creditworthiness of the issuer.
>
> Insisting on benchmark disclosure will mean issuers will also need to ensure that they have certain procedures in place in order to comply with the benchmarks e.g. in forecasting cashflow regularly for liquidity reporting purposes. This could be lost if the enhanced disclosure requirement is removed.
>
> We therefore feel that issuers should still be subject to the benchmark disclosures even after the debentures are rated. However, we will consult further with established issuers of rated debentures (i.e. those who had issued rated debentures before our consultation paper was published in August 2007) over the coming months.

Listed debentures

13 Similarly, some respondents felt that listed debentures should not be subject to the benchmark disclosures.

14 The primary reason for this belief was that issuers of listed securities are already subject to greater requirements in terms of admission to listing requirements, continuous disclosure and supervision by the relevant market licensee (e.g. the ASX). However, one respondent questioned whether many of the issuers of listed unrated debentures would meet the proposed liquidity benchmark.

> *ASIC's response*
>
> The admission to listing requirements, continuous disclosure obligations and supervision by the relevant market licensee associated with listing sufficiently distinguish listed debentures from other debentures. For this reason, we have decided to maintain the position in the consultation paper and exclude listed debentures from the scope of our guidance and expectations.

Should particular classes of issuers be excluded?

APRA-regulated entities

15 CP 89 asked for submissions about whether APRA-regulated entities and their wholly owned subsidiaries should be excluded from the disclosure regime.

16 Respondents were varied in their submissions, some claiming that the regime for APRA-regulated entities provided enough protection, others stressing the importance of the benchmark disclosure and of a level playing field.

> *ASIC's response*
>
> We feel that the enhanced disclosure regime will provide important disclosure to investors that are not provided merely by being APRA-regulated. The subsidiaries of APRA-regulated entities in particular should not be exempt purely due to their relationship with their parent, given that APRA-regulated entities cannot give open-ended guarantees to their subsidiaries. We therefore feel that these entities should still be subject to the benchmark disclosure regime.

Internal use issuers, membership and non-commercial ventures

17 Some feedback was provided suggesting that exemptions should apply where debentures were associated with internal users (e.g. funds raised for internal working capital purposes), or membership or closed schemes (e.g. franchise arrangements).

> *ASIC's response*
>
> We feel that the enhanced disclosure regime will provide important disclosure that would benefit holders of debenture relating to internal use, membership and non-commercial ventures.
>
> The 'if not, why not' approach allows issuers to explain why they do not meet particular benchmarks that are inappropriate to their business model when compelling reasons exist. We have also refined the application of the benchmarks for particular sectors: see Section C.

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C Benchmarks

Key points

The following section provides information related to each of the benchmarks that were proposed in CP 89:

- Credit rating (see paragraphs 18–24);
- Equity capital (see paragraphs 25–28);
- Liquidity (see paragraphs 29–35);
- Lending principles – loan-to-valuation ratio (see paragraphs 36–40);
- Loan portfolio (diversification and security) (see paragraphs 41–45);
- Valuations (see paragraphs 46–51);
- Related party transactions (see paragraphs 52–57);
- Rollovers (see paragraphs 58–65); and
- Proposed additional benchmarks (see paragraph 66).

Credit rating

18 Experience suggests investors find it difficult to assess the credit risk involved in unlisted debentures.

19 Credit ratings by recognised agencies are a well-established and widely used method of assessing and communicating the credit risk of an issuer and its debt securities.

20 To improve disclosure of credit risk in CP 89 we proposed incentives for issuers to:

- have their debentures rated for credit risk (i.e. the risk that the principal will not be repaid at the end of a relevant period);
- use a recognised credit rating agency for this purpose;
- state the rating and who it is from in their prospectus and briefly explain the rating (i.e. what it says about the risk of the investor not getting their money back);
- ensure the rating remains current; and
- if the debentures are not rated as to credit risk—state in the issuer's prospectus that they are not rated and the reasons for this.

(See CP 89, proposal D2).

21 Some respondents felt that credit ratings would not be a suitable method of assessing and communicating risk. Concerns varied from the relevance of ratings providers in their capacity to properly assess and rate debentures, to availability of better alternatives and the cost and time involved in implementation.

22 There was also concern about whether unsophisticated investors would understand ratings.

23 Some submissions offered alternatives such as investment research companies—who some believed were better placed to provide reports to assist investors to make informed decisions—or using company auditors.

24 Overall, most respondents felt that credit ratings would at least help communicate the credit risk associated with a debenture offering. Those who did agree with the approach believed it prudent to only use traditional well-established credit rating agencies to maintain the best possible standards.

> *ASIC's response*
>
> We considered exempting membership and closed schemes from this benchmark, as some respondents suggested that for these debentures the burden of compliance may be disproportionate to the regulatory benefit. However given the difficulty of defining these classes, we feet it is more appropriate for these issuers to use the 'if not, why not' regime (if necessary) to explain why the rating was not obtained in their particular case.
>
> In response to practical concerns for unsophisticated investors, we will require disclosure of what the particular credit rating agency summarises the credit rating to mean. This is generally available on the rating agencies' websites. There is also good guidance on this produced by the ASX. We will also be providing investor education materials to assist investor understanding of these credit ratings.
>
> Only Standard & Poor's, Moody's and Fitch credit ratings fall within the first benchmark. We believe that as debentures are a credit product, it is most appropriate that they get a credit rating from a recognised credit rating agency. Generally, credit risk is the most important risk that investors need to consider for these products.

Equity capital

25 CP 89 proposed that, in order to address the issuer's financial structure and ability to meet loan obligations on time, issuers should use the following as equity capital benchmarks:

(a) where the primary activity of the persons to whom the issuer lends funds directly or indirectly is property development—the issuer should maintain a minimum of 20% equity;

(b) in all other cases—the issuer should maintain a minimum of 10% equity; and

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

$$\frac{\text{equity capital}}{\text{total debt + equity capital}}$$

(See CP 89, proposal D3).

26 The majority of respondents felt the minimum 20% equity capital where the primary activity of the persons to whom the issuer lends funds directly or indirectly is property development was appropriate. Some suggested there should be an even higher rate for mezzanine property finance than for first ranking security property financing.

27 A number of submissions suggested that for non property-related debentures, the 10% equity capital level is too excessive, that it exceeds current industry practice (which submissions indicated that for finance companies is currently an equity ratio of 7.96% on average).[1] There were additional concerns that setting the equity ratio benchmark too high may encourage issuers to take on riskier investments in order to provide a better return to equity holders.

28 Other respondents suggested a more flexible and sophisticated approach should be adopted having regard to the underling asset, similar to the approach adopted by APRA (e.g. Basel 2 capital adequacy type regime).

ASIC's response

We have decided to keep the benchmark the same, except we will reduce the equity capital required from 10% to 8% for non property-related debentures.

We appreciate the desire for a more flexible and sophisticated approach, but we feel that a prudential-style capital adequacy regime is too complex and inappropriate for ASIC to adopt for debenture prospectuses.

Liquidity

29 The liquidity of an issuer is a powerful indicator of its short-term financial health. For debenture issuers it is relative liquidity (i.e. short term assets relative to short term liabilities) that we were particularly concerned with.

30 In order to address the issuer's financial structure and ability to meet loan obligations on time, in CP 89 we proposed that issuers:

(a) estimate their cash needs for the next 3 months; and

(b) ensure that at all times they have on hand cash or cash equivalents sufficient to meet their projected cash needs over the next 3 months.

(See CP 89, proposal D4).

[1] Submission from Westlawn Finance Limited and Australian Finance Conference.

31 The balance of respondents believed that a liquidity reserve was good practice and many had already established benchmarks themselves. However there was some concern that enforcing common guidelines may restrict issuers' financial flexibility.

32 There was a wide range of cash definitions suggested; most common were established definitions such as AFSL requirements or accounting standards. There were several submissions with unique interpretations of when an asset is readily marketable.

33 Many respondents emphasised the importance of including a maturity profile comparison of assets and liabilities.

34 The vast majority agreed that including rollovers in estimates is an appropriate and more realistic approach. Many of these added that rollover estimates would need to be justified by historical experience.

35 The majority of respondents also believed that a credit facility should also be included in estimates.

ASIC's response

We welcome the positive response to this proposal. We still feel a simple broad benchmark is essential to properly address this key indicator and to allow investors to make comparisons between debenture prospectuses. If, for any reason, issuers are unable to meet this benchmark then the 'if not why not' approach would provide additional disclosure to investors so that they could assess its impact on their investment decision.

Given the variety of responses we received concerning 'cash and cash equivalents', we have decided to adopt the Accounting Standards definition. AASB 107 defines 'cash' as comprising 'cash on hand and demand deposits', and 'cash equivalents' as 'short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value'.

In the final regulatory guide we have clarified that estimating cash needs and inflows should be on reasonable grounds and can include reference to historical experience (especially expectations of rollovers). Where the issuer has no or little history of issuing debentures, it may not be in a position to make a reasonable estimate and hence may have to exclude rollovers from its estimate.

Concerning maturity profiles, we feel that particularly in the property related debenture space, it is worth providing additional disclosure regarding the matching of maturities of assets and liabilities (factoring in rollovers of the loans) and interest rate spread. We have provided further guidance on this in the final regulatory guide.

Lending principles—loan-to-valuation ratio

36 Many issuers of unlisted debentures on-lend the funds lent to them by debenture holders. The primary assets of the issuer are the loans they make to others. The quality of these loans is a key element in the financial position and performance of the issuer.

37 CP 89 therefore proposed a benchmark which required issuers to maintain the following loan-to-valuation ratios:

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

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

(See CP 89, proposal D5).

38 Generally there was support for this benchmark and these ratios, although some suggested that this benchmark should only relate to property-related lending.

39 There was concern from some respondents that we had not adequately taken into account second mortgages or mezzanine loans, and leasing/hire purchase agreements (where in some cases loan-to-valuation ratios are either much higher or not used at all).

40 Many respondents felt to support the loan-to-valuation ratios, it would be beneficial to additionally require disclosure relating to lending practices, default rates and arrears.

ASIC's response

We have decided to confine this benchmark to property-related lending practices.

We have also decided to include with this benchmark an obligation for entities to report on default rates. Additionally we will require issuers to disclose their lending policy.

Loan portfolio (diversification and security)

41 The quality of an issuer's loans is important at an overall loan portfolio level, as well as the individual loan level. A key way issuers manage the overall risk of a loan portfolio is to ensure that it is well diversified.

42 In CP 89 in order to address lending practices, we proposed issuers disclose:

(a) how many loans they have;

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

(c) by number and value, what proportion of loans are in default or arrears;

(d) by number and value, what proportion of the total loan monies are lent on a ‘secured’ basis and what is the nature of the security; and

(e) by number and value, what proportion of the total loan monies they have lent or expect to lend to their largest borrower and 10 largest borrowers.

(See CP 89, proposal D7).

43 Most respondents agreed we had identified the relevant principles of customer, geography, security and loan amounts. These submissions also believed that disclosure of diversification would give the investor a clearer view on the risk appetite of the issuer. However, some respondents were concerned that these principles were not appropriate for their particular business.

44 There were many who believed it was simply not feasible to apply this benchmark to issuers where the number of their loans may be in the hundreds (or thousands) and the amount of the loan may range from around ten thousand to five or more million.

45 There were similar concerns that our proposed benchmark would have required a 12-month forecast, with some submissions indicating a preference of providing quarterly updates of the actual portfolio.

ASIC’s response

The diversification and security of a loan portfolio is only relevant to issuers who on-lend the funds raised through the debentures. Therefore, the benchmark should only apply to these issuers.

Where there is significant diversification, we agree that disclosure about the details of every single loan is unnecessary. We have clarified in our final regulatory guide that this is not expected.

We acknowledge the forecasting concerns and agree that issuers should only disclose expected future diversification if they have a reasonable basis for making these statements. This limitation is intended to ensure consistency with ASIC’s policy regarding forward-looking statements. What we would expect to see under this benchmark is disclosure of the issuer’s lending policy (e.g. their policy may be not to lend more than 5% of their loan funds to one borrower or not to lend more than 10% to borrowers in a particular geographic region).

Valuations

46 CP 89 stressed the importance of valuations, especially the need for investors to be confident that valuations are performed by independent experts and that the process is transparent. To achieve this, we proposed that issuers take the following approach to valuations:

(a) properties (i.e. real estate) should be valued on a ‘cost’, ‘as is’ and (for development property) ‘as if complete’ basis, and all of these should be disclosed to investors;

(b) for other assets, valuations should be based on the market value of the underlying property or asset;

(c) issuers should disclose how often they obtain valuations, including how recent a valuation has to be when they make a new loan;

(d) issuers should establish a panel of valuers and ensure that no one valuer conducts more than 1/3 of the issuer's valuation work; and

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

(See CP 89, proposal D9).

47 The majority of submissions supported the need for a valuation benchmark and many were generally supportive of our approach.

48 There was strong support for expecting that valuers be registered or licensed in their state where applicable, or be part of a recognised industry body that followed a code of conduct. Some respondents went further suggesting valuers should have at least 5 years experience in the particular field of valuation and appropriate personal indemnity insurance.

49 There were concerns about expecting the trustee (rather than the issuer) to appoint the valuer, with some feeling trustees generally do not have the expertise for such a task and that it would be too onerous.

50 Many respondents were against making valuations available to investors claiming, not only would it be impractical, but it was also have little benefit to the investor as they were very complex.

51 There was also feedback that the quality of valuations may depend on the quality of the information and instructions provided by the issuer.

> *ASIC's response*
>
> We have decided to limit this benchmark to real property and property related debentures.
>
> We do not expect disclosure about the valuations of particular properties in an issuer's portfolio unless the property involved is worth 5% or more of monies lent.

Related party transactions

52 Funds raised through debenture issues are often on lent to associated companies or businesses (i.e. related party transactions).

53 There is an increased risk that such lending decisions will not be made on arms' length commercial terms, and that the debenture issuer who makes the loans will not monitor performance as rigorously as it would in an arms' length transaction.

54 In CP 89 we proposed that issuers should disclose the following to address this specific area of lending risk:

(a) how many loans they have made or expect to make in the coming 12 months to related parties; and

(b) what assessment and approval process they follow with related party loans (e.g. are they subject to approval of the trustee).

(See CP 89, proposal D10).

55 Almost all respondents agreed that we had identified the relevant issues and there was a consensus that these transactions need to be very robustly assessed and independently verified. Some identified the high risk is related to the conflicts of interest when dealing with related parties.

56 Several submissions also highlighted the need to disclose prior ranking of loans to investors to ensure there is awareness of their loan positioning.

57 There was general agreement that additional capital would be too onerous a to comply with here.

ASIC's response

We believe in accordance with the submissions that the related party transaction benchmark is appropriate for all issuers who on-lend funds. Related party loans are less likely to be monitored as robustly as third-party loans, which can affect valuations, loan-to-valuation ratios and credit assessment processes.

Rollovers

58 It is important that investors fully understand an issuer's approach to rollovers through clear disclosure in the prospectus.

59 CP 89 therefore proposed as a benchmark that issuers should clearly set out their approach to rollovers (see CP 89, proposal D11). We also asked whether the 'default' position should be that the principal is repaid unless the investor expressly decides to rollover.

60 There was clear support for the disclosure of an issuer's approach to rollovers.

61 In relation to what the 'default' position should be at the time of rollover, the submissions were divided.

62 Some thought that it was more practical and safer for investors to have to 'opt in' to a rollover and thought that repayment should be compulsory unless they 'opt in'. Others thought it was more practical for the investment to continue unless the investor provided a clear 'opt out' notification.

63 A few entities claimed they normally move the money to an 'at call' account until they are notified what to do with the investment and that this was the best methodology.

64 Some respondents thought it was sufficient protection to simply ensure investors were clearly informed of what was going to happen to their investment, and what their options were, prior to the rollover period.

65 Most respondents agreed that the current disclosure document should be made available to investors at or before the time they are considering whether to rollover or withdraw their funds.

> *ASIC's response*
>
> We have decided to continue with the proposed benchmark that an issuer's policy on rollovers should be clearly disclosed in all prospectuses.
>
> We also state in the final regulatory guide that best practice is to make the current prospectus available at the time of rollover. However, we will *not* be requiring that as a default position, monies be refunded if there is no positive election by the investor to rollover.

Proposed additional disclosure

66 There were some useful suggestions put forward for additional disclosure benchmarks, in particular:

(a) an interest cover ratio (i.e.net profit before tax and interest as a percentage of interest). The higher the ratio, the more chance an investor has of the entity being able to meet its interest commitment;

(b) experience and reputation of the directors and management of the borrowing company (and in a similar vain a 'fit and proper management' benchmark); and

(c) an assessment of the ability (capacity) of the borrowers to repay.

> *ASIC's response*
>
> We agree that the issuer should explain what they are using the funds for. Investor research suggests that people do not understand what the funds are being used for. We have included guidance to this effect in the final regulatory guide.
>
> Secondly, we agree that issuers should provide clear disclosure that these products are not the same as products of prudentially regulated bodies (e.g. term deposits), and that there is a risk that investors may lose some or all of their money.

D Upfront and ongoing disclosure

67 ASIC proposed that issuers disclose whether they meet the benchmarks and if not, why not. 'Why not' means explaining how an issuer deals with the issue underlying the benchmark.

68 Disclosure on an 'if not, why not' basis would be required:

(a) upfront in the prospectus (see proposals E1–E2); and

(b) as material changes occur, in a replacement prospectus, supplementary prospectus or continuous disclosure notice (see proposal E3), and at least twice a year, in quarterly reports to trustees (see proposal E4).

69 The majority of submissions did not expect practical problems with expecting disclosure against the benchmarks in prospectuses as long as the benchmarks were adequately defined.

70 However, many were concerned that this disclosure may confuse retail investors and result in very long, complex disclosure documents. They were concerned that disclosure against the benchmarks may be too complex for many ordinary investors, and that we should focus on simple warnings instead. A few submissions mentioned the necessity to ensure disclosure is in plain English and limited to a few pages.

71 The majority of submissions supported the 'if not, why not' approach. Many submissions agreed that the 'if not, why not' approach gave an appropriate amount of flexibility for issuers who did not meet the benchmarks for good reasons. However, some felt that 'if not, why not' disclosure would be expensive and time consuming.

ASIC's response

The majority of submissions supported our 'if not, why not' approach to disclosure, and our expectations of up-front and ongoing disclosure. We have decided to maintain our position (i.e. as set out in CP 89) on this topic.

We have included some additional guidance in the final regulatory guide on making it clear to investors that debentures are not and should not be confused with deposit products.

We will monitor the enhanced benchmark disclosure regime and, as set out in CP 89, we will continue to work on further investor education and guidance material.

E Advertising

72 Advertising used to promote some unlisted, unrated debentures can create unrealistic expectations about the relative safety of debentures.

73 In CP 89, we proposed the adoption of new advertising guidelines including:

(a) issuers should not:

(i) include the terms ‘secure’, ‘secured’, ‘guaranteed’, ‘safe’, ‘deposit’, ‘first ranking’, ‘no fees’, or any comparison with bank deposit products;

(ii) state or imply that the investment is suitable for a particular class of investor (e.g. ‘this product is suitable for a conservative investor’ or ‘this product is suitable for a self-managed super fund’);

(b) disclosure of performance against benchmarks should be included in advertising for these debentures;

(c) media should play some role in vetting advertising.

(See CP 89, proposals F1–F2).

74 Many submissions support having guidelines about appropriate and inappropriate advertising. However, some were against the introduction of a warning that unrated debentures are ‘high risk’ as this might not actually be true in all cases (e.g. some unrated debentures may be low risk). A few still thought they should be allowed to use terms such as ‘secured’ and ‘no-fees’ where they could factually prove it.

75 A key point made was that while the consultation paper proposed that the term ‘deposit’ should not be used, the law sets out the only ways in which a borrower is permitted to describe debentures. Debentures other than mortgage debentures of secured debentures may only be described as ‘unsecured notes’ or ‘unsecured deposit notes’.

76 While there was overall support for including benchmark performance in advertising there was some concern that it should not apply to all types of media, especially radio and television where any additional or lengthy ‘tags’ required of radio and television advertising could be impractical, confusing and may lead to negative financial consequences.

77 Some believe that the media should have no role to play in vetting material, but should act responsibly. A few stated that the obligation is with the issuer of the product not the publisher of the advertisement. Although some believed there were steps that could be taken on this issue such as addressing the standard format of issuers and the key terms they use.

78 The Australian Publishing Bureau believed that ASIC should develop an advertising guideline emphasising the use of plain English over jargon.[2]

[2] See discussion in submission by Australian Publishers’ Bureau, p 5-6.

ASIC's response

Based on the feedback that we received on advertising from issuers and publishers, we have decided to conduct further consultation on the issue. We have issued Consultation Paper 94 *Debenture advertising* (CP 94), which seeks comments on a draft regulatory guide on debenture advertising.

The draft regulatory guide sets out advertising standards for issuers and our expectations of publishers to adopt specific screening methods to detect and refuse debenture advertisements that do not comply with the advertising standards.

The suggested advertising standards include adopting a guiding principle against the use of terms that infer that debentures are free from risk or comparable to a bank deposit (e.g. 'secure', 'guarantee') in all advertisements. They also propose that issuers should not say anything in advertisements that is inconsistent with the prospectus, in particular the disclosure regarding the benchmarks.

The suggested advertising standards also state that advertisements should not include any reference to interest rates or returns unless they also include either:

- a current credit rating of the debenture received from a recognised credit rating agency; or
- a statement that the debenture does not have a current credit rating from a recognised credit rating agency, which means that no external assessment has been made about the risk of investors getting all or part of their principal investment back.

Further, where a credit rating is quoted it should be accompanied by information about who the rating is from and what the rating means. These disclosures should be as prominent as the credit rating.

F Trustees

79 The law requires that whenever debentures are offered under a prospectus, the issuer must appoint a trustee. The trustee's role under the trustee deed and the *Corporations Act 2001* (Corporations Act) is to 'exercise reasonable diligence' in monitoring the issuer's ability to repay the debentures (e.g. its financial position and performance)

80 In CP 89 we proposed in summary that:

(a) trustees should actively monitor the financial position and performance of the issuer;

(b) trustees should assess and form a view (and record this in writing) about the financial position and performance of the issuer at least quarterly; and

(c) where the trustee forms the view that the issuer is failing to meet the promises made in their disclosure documents or that there have been material adverse changes in the financial position or performance of the issuer, the trustee should notify both ASIC and the investors promptly.

81 Most respondents agreed there would be no practical or commercial problems with expecting trustees to take on this role. Some investors believed it was already part of their role. Some concerns were raised about the level of expertise needed to do so. Many suggested that trustee fees would need to increase as a result.

82 Trustees indicated support for more actively monitoring the activities of debenture issuers, but suggested that if they are to be required to monitor compliance with the benchmarks, the benchmarks should be included in the Corporations Act.

83 Most believed setting out this monitoring role in the trust deed would be too prescriptive. One said that adding benchmarks into deeds might introduce inconsistencies. There were some who agreed though, stating that if the trustee needs to act then this must be set out in the deed.

84 Most believed that trustees should approve rather than appoint auditors and valuers. However they believed they should still have the power to appoint if the need arose.

85 Many submissions have suggested that the more appropriate entity to verify compliance with benchmarks is the company auditor.

ASIC's response

The trustees have made submissions regarding the associated cost increases that this proposal would involve. Issuers supported increased roles for trustees but have indicated reluctance to pay

higher fees. We believe that trustees, given their existing statutory duties, should be expected to perform this task; and the regulatory benefit to investors would outweigh the associated costs.

Our final regulatory guide states that we will expect trustees to actively monitor the ability of the issuer to repay monies borrowed when they become due as part of fulfilling their existing statutory obligations.

In practice, we expect that for most trustees an effective way to achieve this is may be to include some or all of the benchmarks in trust deeds. However, this is a matter for each trustee to consider.

G Timing

86 CP 89 detailed the timing expected in relation to the implementation of the new benchmark disclosure regime. The suggested timing was that on or after 1 December 2007 new issuers and existing issuers should ensure:

- prospectuses (in the case of new issuers) and new prospectuses (in the case of existing issuers) issued follow the proposed 'if not, why not' approach to disclosing against the benchmarks;
- they use the new advertising benchmarks; and
- ongoing disclosures specifically refer to the issuer's performance against the disclosure benchmarks (or where the issuer takes an alternative approach on one or more benchmarks, against the alternative approaches).

87 Additionally, it was proposed that existing issuers should lodge by 1 March 2008 an ongoing disclosure document specifically referring to the issuer's performance against the disclosure benchmarks (or where the issuer takes an alternative approach on one or more benchmarks, against the alternative approaches).

88 Many submissions felt the timing of the new regime may be too onerous, especially in respect to existing issuers given the implementation that needs to take place. Various suggested dates were at least 6–12 months past the proposed timetable.

89 Other submissions stressed the importance of this new disclosure project, and that retail investors should be provided with greater protection as soon as possible.

ASIC's response

Protection of retail investors is one of our top priorities and we see this new regime as a positive step forward which will provide necessary disclosure to help ensure that investors understand the risks, assess the rewards being offered, and can better decide whether debentures are suitable for them.

We have therefore decided that:

- new issuers should still be subject to the 1 December 2007 timing schedule; but
- we will extend the implementation of the requirements for new prospectuses from existing issuers to 1 March 2008.

Appendix 1: List of non-confidential respondents

- Abacus Australian Mutuals
- Angas Securities Limited
- Australian Finance and Leasing Ltd
- Australian Finance Conference
- Australia Pacific Exchange Limited
- Australian Publishers' Bureau
- Australian Shareholders' Association
- Balanced Securities
- Bidgee Finance Ltd
- Choice
- Commercial Radio
- Consumer action Law Centre
- CPA Australia Ltd
- Eurofinance Capital Limited
- Ferrier Hodgson
- Financial Industry Complaints Service Ltd
- FINSIA
- FPA
- FSI Consulting Pty Ltd
- Geoffrey Hodgkinson
- Goldman Sachs JBWere
- Grant Thornton Australia
- Grenfell Securities Limited
- GR Finance Limited
- Hargraves Secured Investments Limited
- Hastings Capital Limited
- Investment and Financial Services Association Ltd
- Institute of Actuaries of Australia
- Landmark
- Law Council of Australia
- Law Society of NSW
- Lewis Securities Limited
- McCullough Robertson Lawyers
- Momentum Mortgages Limited
- Moodys
- NICRI
- North State Finance Limited
- Paul Resnik Consulting Group (Fina Metrica)
- Property Invesment Research
- Price Waterhouse Coopers
- Profinance Limited
- Progressive Mortgage Company
- Real Estate Institute of Australia
- Rivwest Finance Limited
- RMBL Investments Limited
- Standard and Poor's
- Strategic Finance Ltd
- Trustee Corporations Association of Australia
- Westlawn Finance Ltd