



Investment & Financial Services Association Ltd

ACN 080 744 163

19 October 2007

Mr Rhys Bollen
Regulatory Policy Branch
Australian Securities & Investments Commission

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Dear Rhys

ASIC Consultation Paper 89 – Unlisted, unrated debentures – improving disclosure for retail investors

We refer to Consultation Paper 89 (CP) setting out proposed ASIC Guidance to issuers and trustees operating in the unlisted and unrated debenture issue sector.

The Investment and Financial Services Association is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries. IFSA has over 145 members who are responsible for investing over \$1 trillion on behalf of more than 10 million Australians. Members' compliance with IFSA Standards and Guidance Notes ensures the promotion of industry best practice.

General Comments

IFSA notes, and shares with ASIC, the concerns over the recent failures within the unlisted and unrated debenture sector, and with the apparent lack of investor understanding of associated investment risks.

We support effective disclosure as a tool for assisting investors to understand investment risk and the need for appropriate investor guidance. We do, however, caution against any tendency through the publication of ASIC guidance to effectively prescribe matters that are likely to increase the costs to debenture issues without necessarily resulting in greater investor protection.

The following comments do not address each of the matters raised in the CP, but focus on the broader policy issues involved with the obligations of debenture trustees under the law and the 'if not why not' proposal addressing specific benchmarks identified in the CP. IFSA notes and generally supports the submission made to ASIC by the Trustee Corporations Association of Australia on Unlisted, unrated debentures – improving disclosure for retail investors.

Obligations of the Debenture Trustee

Debentures are issued in accordance with the requirements of Chapter 2L of the Corporations Act 2001 and under a trust deed between the debenture issuer and the trustee representing investors.

Unlike registered managed investment schemes, the powers and responsibilities of the debenture trustee are far more limited. While the responsible entity of a registered managed investment scheme has responsibility to act in the best interests of members and for the operation of the scheme, the debenture trustee in effect stands in the shoes of investors and does not have any operational responsibility for the business/undertaking in respect of which the debentures are issued. It should also be noted that the responsibility of the issuer to debenture holders is as creditors of the company.

The existing debenture provisions of the Act have been in operation for many years and provide debt investment as an alternative form of investment to either share equity or managed investments. To the extent that it is considered that rights of debenture holders are inadequate, recommendations should be made to Government for review, broad consultation and possible amendment of Chapter 2L of the Corporations Act. If a debenture trustee is to have a more interventionist role on behalf of debenture holders this needs to be reflected in the law itself and cannot be achieved through disclosure alone or Regulatory Guidance.

Disclosure Obligations - Benchmarks

The CP builds on the general prospectus disclosure obligations of section 710 of Chapter 6D of the Corporations Act. Absent amendment to the Act, proposed ASIC Regulatory Guidance on issuers meeting prospectus disclosure obligations against specified benchmarks is a positive initiative.

While we agree that benchmarks are a useful tool for assessing the risk/return ratio of an investment opportunity, as recognised by ASIC in the CP, benchmarks themselves are not guarantees of success against failure. Additionally, given the different categories of debenture offering with differing risk profiles, a prescriptive approach to disclosure using common benchmarks could generate possible systemic risks not present under the existing more general disclosure requirements.

It would be undesirable if consumers were to erroneously apply identical benchmark requirements across different debenture categories given their different risk profiles. Disclosure and the application of the proposed benchmarks should, in our view, reflect segmentation within the unlisted, unrated debenture sector. While there is support in principle for the proposed benchmarks facilitating a more structured approach to debenture prospectus disclosure, there is a variation in the views of IFSA members that are involved with the unlisted unrated debenture sector on particular benchmarks.

The support for reporting against the proposed benchmarks is qualified particularly in the case of Benchmark 1: Credit Ratings, and Benchmark 2: Equity Capital. While we assume that the concerns of members will, in part, be addressed through the

proposed ASIC consumer education initiative the concerns underline the need for flexibility in the application of the benchmarks to particular categories of debenture offering.

Benchmark 1: Credit Ratings. Where a debenture offering seeks to raise less than \$100M the availability of an acceptable investment grade rating is questionable where the issuing body is a relatively small institution. Recognition needs to be provided in Regulatory Guidance issued.

We also note that credit ratings while a useful assessment of a business do not guarantee performance. For example, the recent Bloomberg report on the US Subprime crisis stated that “the Basis Capital funds had the highest five-star ratings from credit –rating firm Standard & Poor’s before the ranking was put “on hold” July 17.” [Bloomberg Report, 29 August 2007].

Benchmark 2: Equity Capital. A range of views have been expressed on the appropriate benchmark against which equity should be held in respect of property developments. We note in this regard that the recent failures (Westpoint, Fincorp and ACR) each involved directly or indirectly property developments and issuers using a high risk business model. Generally it is considered that the higher the risk the higher the equity capital requirement should be and that a minimum 20% capital requirement for debenture funds invested directly or indirectly in property developments was not high enough given the risk profile of the investment.

Conclusion

The proposed use of benchmarks as part of prospectus disclosure is a positive development. However, prospectus disclosure alone will not be sufficient to address a number of the fundamental structural issues involved in the issue of debentures and the rights of debenture holders to protect their investments.

While we acknowledge that ASIC is able through Regulatory Guidance to seek to ensure informed investment through disclosure, IFSA members consider that a basis exists for the review of Chapter 2L of the Corporations Act.

We would be pleased to provide further detail or to discuss issues raised in this submission.

Yours sincerely



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