

**Discussion paper: Development of the
retail corporate bond market:
streamlining disclosure and liability
requirements**

Australian Government

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INTRODUCTION

1. This paper seeks views from interested organisations and individuals regarding a proposal for encouraging the development of the corporate bond market in Australia, and particularly issuance to retail investors by reducing the burden of disclosure and liability requirements for such issuance.
2. The November 2009 Johnson Report on 'Australia as a Financial Centre: Building on our Strengths', in assessing the strengths and weaknesses of Australia's financial sector, identified the domestic corporate bond market as one area of relative weakness. The Report recommended that the regulatory requirements for listed companies that issue high quality corporate debt to retail investors be reduced. It stated that: 'Such issuers would no longer be required to issue a detailed prospectus. Rather, a shorter prospectus could be issued, cross-referencing all relevant documents already lodged with the Australian Securities and Investments Commission (ASIC) or the market operator. Those companies with a program of issues over time could use a base prospectus with a supplementary prospectus for each new issue.' (Recommendation 4.6)
3. Currently, issuers of retail corporate bonds in Australia must issue a full prospectus unless they qualify for the ASIC's 'vanilla bonds' class order relief (CO 10/321). Only one issuer has so far explicitly used ASIC's class order relief (although some financial sector issuers have modelled retail bond offer documents on the class order).
4. As part of its banking package announced in December 2010, the Government tasked Treasury 'to better align disclosure for retail corporate bond issues with the process already allowed for share entitlement offers, which provides a very high level of protection for investors, as well as reduced transaction costs for issuers.'
5. The paper invites discussion on the proposition that the retail corporate bond disclosure and liability regime should facilitate a sustainable corporate bond market by:
 - reducing the regulatory burden on/barriers to issuance facing potential issuers while maintaining appropriate investor protection;
 - ensuring that investors are made aware of the key features and risks associated with buying a particular bond from a particular company (noting that bonds will be made available to both existing and new investors), while reducing the complexity of prospectuses and making them easier for investors to understand; and
 - ensuring that there is an appropriate liability regime in place which balances investor protection against ensuring that directors are not unduly burdened.

POLICY BACKGROUND

ISSUER CONSIDERATIONS

6. When Australian companies wish to obtain funding, they either:
 - access overseas debt markets (generally the United States, the United Kingdom and Europe);
 - borrow from the Australian wholesale market;
 - borrow from Authorised Deposit-taking Institutions; or
 - issue equity (for example, shares or rights) or issue some combination of debt and equity (for example, hybrids or convertible bonds).
7. Medium and small companies typically do not have access to foreign (or domestic wholesale) debt markets, so are restricted to bank borrowing or issuing equity. In relation to debt, there is a very high degree of bank intermediation. Accordingly, Australian companies may have difficulty raising funds when there is tightening in foreign and domestic wholesale markets (and consequently a tightening in Australian domestic bank lending).
8. Overseas experience suggests that, compared to Australia, Europe, the United States, and to a lesser extent New Zealand and the United Kingdom, all have thriving retail corporate bond markets.
9. Large, medium and small Australian companies would benefit from being able to issue debt to Australian retail investors (that is, retail corporate bonds) in a cost-effective way. Currently, the process for issuing corporate bonds to retail investors is costly and onerous compared to other avenues for raising funds as the law requires the issuing of a full prospectus and directors are subject to personal liability for the content of the prospectus.
10. Despite this, a number of companies have recently issued debt to retail investors, including Primary Health Care, Australian Unity, Commonwealth Bank, Bendigo Bank, Woolworths and Origin Energy.

INVESTOR CONSIDERATIONS

11. Prospectuses and other disclosure documents are often quite lengthy and detailed documents. Research and consumer feedback suggests that the average retail investor finds it difficult to absorb the large volume of information in some disclosure documents and is therefore unable to identify, or is deterred from identifying, essential core information. This reduces the effectiveness of disclosure and can make it difficult for investors to compare products, which may discourage them from taking up products that they are not familiar with, such as corporate bonds.
12. There have been a number of reforms in recent times to increase the effectiveness of financial product disclosure including by reducing the length of disclosure documents and being more prescriptive about the content of disclosure documents. Examples of shortened disclosure include: short form product disclosure statements (PDSs) for First Home Saver Account, margin lending, superannuation and simple managed

investment products; short form and transaction specific prospectuses; rights issue cleansing notices; and key fact sheets for credit cards and home loans and some insurance products.

13. Access to a shorter, simpler document may encourage the take up of corporate bonds by retail investors. However, the benefits of shorter disclosure need to be weighed against the need to fully inform investors about risky or complex products.
14. During the global financial crisis (GFC), many retail investors experienced a decline in the value of their portfolios, with a number of investments failing altogether. The GFC also exposed the inherent dangers of more complex and higher risk investments. Since that time, many investors, including a growing number of self-managed superannuation funds (SMSFs), have sought out lower risk investments.
15. Greater availability of retail corporate bonds, which are more highly ranked than shares, may allow investors to diversify into products which potentially provide a regular income stream prior to and during retirement. However, not all debt offerings are equal in terms of risk and complexity. Some of these securities may be akin to hybrids in that they have features of equity as well as debt. Such securities have higher risks, and more detailed disclosure of their risks and features will generally be required than for 'vanilla' bonds.

IMPEDIMENTS OTHER THAN DISCLOSURE /LIABILITY

16. The Johnson Report noted that many of the factors discouraging domestic bond issuance were structural in nature, including that:
 - the large Australian banks have provided a significant proportion of the non-financial corporate sector's borrowing needs (albeit at shorter maturities than desired, leading to refinancing risk); and
 - to the extent that companies require longer maturity or additional debt financing beyond bank loans, Australian companies can access the much more liquid corporate bond markets in Europe and the United States – however, such access is neither cheap nor easy, especially for smaller and lower credit rated Australian companies.
17. As a result, while addressing disclosure and liability issues may encourage the issuing of bonds to retail investors, it will not address these other structural issues. The Government has also announced that it intends to list Commonwealth Government Securities making them more accessible to retail investors and providing a benchmark risk free return for bonds. This should further assist in the development of the corporate bond market.

HOW REDUCED DISCLOSURE AND LIABILITY REQUIREMENTS COULD ASSIST ISSUERS AND INVESTORS

18. Allowing issuers to issue a shorter prospectus, and reducing the liability requirements for directors, in respect of bonds that are lower risk and less complex, would address the impediments for issuers by reducing the legal and other compliance costs of disclosure and the amount of due diligence required before boards sign off on prospectuses. Shorter, more standardised prospectuses would also assist investors because it will be easier for them to locate the information that they need to know

before making an investment decision. Removing directors' deemed liability (as discussed later in this paper) would not materially reduce investor protection because the company and anyone associated with preparing the prospectus will still be liable.

WHAT IS A BOND?

19. 'Bonds' are not specifically defined in the *Corporations Act 2001* (the Act). For the purposes of Chapter 6D they are a 'debenture' or 'security': sections 9, 700(1) and 761A. Put simply, corporate bonds are issued to investors by companies, in return for cash. Interest is paid to the investors over the life of the bond, with the payment terms dependent on the details of the issue. The principal is repayable on maturity. By definition, a retail corporate bond is issued to investors who include 'retail clients' as defined in sections 761G and 761GA, in contrast to wholesale issues which exclude 'retail clients'.
20. While bonds are a 'financial product' for the purposes of the Act, they are specifically excluded from the Part 7.9 financial product disclosure rules (under section 1010A) and are therefore subject to the general prospectus disclosure rules of Chapter 6D. The starting point is that a full prospectus is required (sections 704-706 and 709), akin to an initial public offering document even when the issuer is already listed and therefore already subject to continuous disclosure requirements. The Act contains a number of general and specific requirements regarding matters that must be disclosed in prospectuses (sections 710 and 711). Subsection 715A(1) says that the information in a disclosure document must be worded and presented in a clear, concise and effective manner. While there is no limit on prospectus length, under ASIC Regulatory Guide 228 (at 228.30), prospectuses should be as short as possible, while satisfying the disclosure requirements.

PROPOSED APPROACH

TAILORING/REPLACEMENT OF CURRENT PROSPECTUS RULES

21. The current rules governing the content of prospectuses could be supplemented or replaced by an optional regime for prospectuses for retail corporate bonds which meet specific conditions relating to both the issuer and the bonds. Issuers could be permitted to produce either:
 - a single simplified prospectus; or
 - multi-stage disclosure, comprising a base document and a second part prospectus (or, for example a term sheet and cleansing statement).
22. In order to achieve the objective of disclosing key information in a shorter document, a number of the general content requirements could be replaced with provisions specific to the new short form prospectuses.

Discussion questions

Should the short form prospectus be compulsory for issuers and bond issues that meet the eligibility requirements set out below, or should it be optional?

Should the use of a two-part prospectus be permitted?

PROPOSED ENTRY REQUIREMENTS/ELIGIBILITY — CONDITIONS RELATED TO THE ISSUER

23. The main proposed eligibility requirement in relation to the issuer could be that it is a listed entity with quoted securities which is compliant with the relevant continuous disclosure and financial reporting requirements of the Act. The rationale for such a requirement would be that, where a disclosing entity issues continuously quoted securities, the market will have already received relevant information through compliance with the continuous disclosure regime and the market operator's rules so that a full prospectus is not necessary.
24. Some proposed conditions are:
- the body has continuously quoted securities (for example, ordinary shares) (or is a wholly-owned subsidiary of a body which has continuously quoted securities where the business of the subsidiary is to act as a financing company for the group);
 - the bond would be a quoted security if it were quoted;
 - the bond will be quoted on issue;
 - the issuer is entitled to use a transaction-specific prospectus for an offer of its existing quoted securities;
 - the issuer's continuously quoted securities have not been suspended for more than five days in the previous 12 months;
 - there must be no determination in force disentitling the issuer from using a cleansing statement for a placement or rights issue¹,
 - on the date of the shorter bonds prospectus, the issuer lodges a copy of the prospectus with the relevant market operator and includes a copy on its website;
 - the auditor's report on the most recent annual financial report, and any subsequent half-yearly financial report, is unmodified; and
 - ASIC may make a determination not to allow issuance via the shorter prospectus if ASIC is satisfied that the issuer has contravened any of certain specified provisions of Chapters 2L, 2M, 6CA or 6D in the previous 12 months.²

1 The body that proposes to issue the bond is not the subject of a determination under subsection 708AA(3), 708A(2), 713(6), 1012DAA(3), 1012DA(2) or 1013FA(3) of the Act.

2 (a) subsection 283AA (1); (b) subsection 283AB (1); (c) subsection 283AC (1); (d) a provision of Chapter 2M as it applies to the body; (e) section 674; (f) section 675; (g) section 724; (h) section 728.

Discussion questions

Are these proposed conditions appropriate? Are there any additional or alternative conditions that should be imposed?

Should unlisted entities with listed securities on issue be allowed to use the shorter prospectus? If so, what, if any, additional requirements would need to be imposed to ensure that investors are informed about the entity's financial position?

Should eligibility extend to a wholly-owned subsidiary of a body which has continuously quoted securities where the business of the subsidiary is to act as a financing company for the group?

Is the requirement for an unmodified auditor's report appropriate, or is it:

- (a) inconsistent with audit requirements in other contexts where unmodified reports are not necessary?
- (b) unnecessary, as some modifications may be positive?
- (c) unnecessary because, if the report is modified, investors will have access to the modified report in order to make an assessment of the relevant issues?

PROPOSED ENTRY REQUIREMENTS/ELIGIBILITY — CONDITIONS RELATING TO THE BOND

25. It is proposed to retain similar conditions for the bond to those in the ASIC Class Order, but with modifications so that the conditions are more relaxed. The aim is to ensure that the bonds do not have any unusual or especially complicated terms. Some proposed conditions are:

- the bond is denominated in Australian dollars;
- the bond is for a fixed term, with the principal payable at maturity or over a defined period of time (that is, the principal amortises);
- the interest may be capitalised, or paid periodically during the term of the bond;
- there must be a fixed or floating rate (that, in the case of a floating rate, comprises a variable market rate plus a fixed margin) – however, this does not prevent the bond from including a feature which increases the fixed margin in certain circumstances provided the potential increase and circumstances in which the increase may occur are disclosed in the prospectus;
- if the bond may be redeemed before the expiry of the fixed term, it may only be redeemed in one or more specified circumstances (whether or not the redemption would be subject to conditions):³

3 (i) at the option of the holder of the bond; (ii) as a result of the acceptance of an offer by the body that issued the bond to buy back the bond (noting that restrictions should not be imposed on buy-backs of bonds); (iii) if all the debentures in the class of retail corporate bonds to which the bond belongs are redeemed – after a change of control of the body that issued the bond, or after a change of law, tax or accounting; (iv) if all the debentures in the class of retail corporate bonds to which the bond belongs are redeemed – on the basis of less than 10 per cent of the debentures on issue being available for issue; (v) on the occurrence of an adverse tax event.

- the bond may be either unsubordinated or subordinated;
- where the bond is issued by a wholly-owned financing subsidiary, the bond must be guaranteed by the listed parent company or a group member (or be supported by similar group financing arrangements that are disclosed);
 - noting that, if the guarantor is a group member and it would not be appropriate to use the financial accounts of the listed parent company to represent the financial position of the group member in the prospectus, then the issuer should be required to seek ASIC guidance/relief in relation to the use of appropriate financial accounts and of a short bonds prospectus;
- the bond is not convertible into any other security,
- the bond is issued to all investors at the same price under the shorter bond prospectus – however, this does not prevent fees being paid to underwriters, sub-underwriters or cornerstone investors in the bond; and
- the issuer is not to offer any debentures for issue to a holder of the bonds under the exemption in subsection 708(14).

'VANILLA' BONDS COMPARED TO MORE COMPLEX PRODUCTS

26. A distinction needs to be made between so-called 'vanilla' bonds with low risks and relatively straightforward terms and conditions, and debt securities which may (for example) allow the issuer to terminate the investment early or suspend interest payments, to subordinate the investor to other creditors, or to specify long term maturity dates (perhaps as much as several decades). In some cases such securities are known as hybrids because they have features of equity as well as debt (for example, conversion features). In November 2011, ASIC warned that hybrid securities should not be confused with government bonds or 'vanilla' corporate debt.
27. It is noted that there are a number of security structures which may be on the border of classification as 'vanilla' bonds versus hybrids. For example, an issue of bonds may be relatively straightforward, except that interest payments are deferrable. Or, it could be that the terms and conditions provide for a complex mandatory interest deferral trigger. In most situations, hybrids contain conversion features which would mean that they would not be able to be issued under a short bonds prospectus.

OTHER REQUIREMENTS THAT COULD BE IMPOSED

28. There are a number of additional requirements or conditions that could be imposed on issuers/issuance wishing to use the shorter prospectus.
29. The issue could be required to be for a minimum amount, for example, a total of at least \$50 million. While such a requirement could maximise the likelihood of a liquid secondary market, it could also limit uptake of the prospectus by small and medium size issuers.
30. Subordination could be prohibited. Alternatively, the fact that the bonds are subordinated (that is, it is a debt), and the effect of this in the event that the company goes into some form of administration, would have to be properly disclosed.

31. Deferral of interest could be prohibited. If interest can be deferred, then the investment may not be providing a regular income stream.
32. A maximum term (tenor) for the bonds (such as 10 years) could be specified. While a 10 year maximum was prescribed in the ASIC vanilla bonds class order, on the basis that investors should not be locked into longer terms (even where the bonds are tradable), not allowing longer tenors could be seen as disadvantaging infrastructure entities and others looking to issue longer dated securities.

Discussion questions

Are the proposed conditions set out above appropriate? Is there a case for adopting any of the alternative conditions? In particular:

- Should subordination be allowed? If so, is disclosure of the fact of subordination sufficient to protect investors?
- Should terms longer than 10 years be permitted? If so, how long should the permitted maximum be, or should there be no maximum?
- Should deferral of interest be permitted, or would this be inconsistent with the notion that bonds provide a regular income stream?
- If eligibility is extended to bonds that have conditions such as subordination, very long terms or deferral of interest, will far more risk disclosure be required and would this undermine the utility of shorter disclosure for these products?

Is there a risk that investors may confuse more complex products with vanilla bonds, if both types of investment are able to take advantage of simplified disclosure? Is it important that the bonds be correctly described? For example, if an issuer offers subordinated bonds or hybrid-type securities, should it be obligatory that the name of the securities not suggest to retail investors that vanilla bonds are being offered?

USE AND AVAILABILITY OF CREDIT RATINGS

33. It would be possible to limit eligibility to investment grade issuers or issuance. While an investment grade rating is arguably a proxy for 'quality', and requiring a minimum rating may make for a shorter prospectus by reducing the amount of disclosure the issuer has to make, such a requirement may unfairly exclude small to medium issuers (who may be the main users of the shorter bond prospectuses). Also, only one of the six Australian Financial Service licensed credit rating agencies in the Australian market is now licensed to provide credit ratings to retail investors; 'investment grade' may be difficult to define; and having an investment grade rating is not a guarantee that an investment is safe. In this respect, it is noted that the Financial Stability Board (FSB) has drawn up a set of principles to reduce reliance on credit rating agency (CRA) ratings in standards, laws and regulations.⁴
34. Stakeholders have raised concerns about the inability to provide to Australian retail investors information about issuer and security ratings published by most of the professional ratings agencies. Ratings, and the analysis conducted by rating agencies,

⁴ Financial Stability Board, *Principles for Reducing Reliance on CRA Ratings*, 27 October 2010.

are seen as an important independent source of information for retail investors when considering an investment in bonds.

35. Many stakeholders consider that the current asymmetry of information where ratings information can be accessed by institutional investors and Australian retail brokers and financial planners (but not their retail clients) is undesirable.

Discussion questions

Should the entity or the bond issue be required to have an investment grade rating (if available)? If so, how would an investment grade rating be defined and mandated?

What other measures could the Government or ASIC take to enable the provision of credit ratings to retail investors?

GENERAL APPROACH TO CONTENT REQUIREMENTS AND PROSPECTUS LENGTH

36. Because the issuer would be required to be listed and have quoted securities, it is proposed that the disclosure requirements would take account of the fact that information about the entity and its financial position will already be available via continuous disclosure. Accordingly, disclosure would place more emphasis on the rights and liabilities attaching to the bond.
37. The prospectus could be required to contain a summary of all of the key information that a client needs to know (and which has not already been publicly disclosed) before deciding to purchase the product. To ensure that the prospectus is a summary of key information, and to help ensure comparability amongst products offered by different providers, it could be desirable to specify the type of content set out in the prospectus by specifying a number of headings and topics (but not prescribed text).
38. There may also be merit in prescribing the maximum length of the prospectus to ensure that the objective of a shorter document is achieved. This has been done in a number of recent reforms, for example with the shorter PDSs for superannuation and simple managed investment schemes being required to be no more than eight A4 pages. As bonds are less familiar to consumers there is a case for a document longer than eight pages. The shortest (standalone) prospectus document produced so far following ASIC's class order (including the terms and conditions and application form) is 53 pages. This is likely to still be longer than many retail investors would be willing or able to read and absorb. A prospectus of somewhere between 20 and 40 pages may be more digestible to the average retail investor, although it would be necessary to assess this through consumer testing.
39. It is recognised that concerns about liability may militate against a shorter document, while greater prescription of content is likely to encourage shorter documents. The changes proposed to the liability provisions, and the prescription of the types of content, are intended to address these issues.

Discussion questions

Should the prospectus contain prescribed headings and/or prescribed content?

Should there be a maximum prospectus length (possibly with ASIC having discretion to increase this)? If so, what should be the maximum length for (a) a standalone prospectus; (b) each part of a two-part prospectus? Could a two-part prospectus be restricted to a maximum total of, say, 40 pages?

Would it be useful to consumer test one or more examples of 'model' prospectuses?

CONTENT REQUIREMENTS

40. A new Subdivision could be inserted into Pt 6D.2 of the Corporations Regulations setting out the form and content requirements for the prospectus. The general content requirements of section 710 would expressly be taken to be satisfied where the prospectus met the prescribed content requirements of the new Subdivision.

PRESCRIBED HEADINGS/SECTIONS

41. Similarly to short PDSs for margin loans, superannuation and simple managed investment products, to facilitate comparability, the prospectus could be required to contain the following sections, possibly numbered and titled as follows:
- 1 – Timetable
 - 2 – About [*name of issuer of retail corporate bond*]
 - 3 – How [*name of retail corporate bond*] works
 - 4 – Benefits of investing in [*name of retail corporate bond*]
 - 5 – Risks of retail corporate bonds
 - 6 – Summary of the financial position of the issuer of the retail corporate bond
 - 7 – Summary of how the retail corporate bonds are taxed
 - 8 – Summary of the interests of advisers and of any fees relating to the retail corporate bond
 - 9 – Summary of how to apply for the retail corporate bond
 - 10 – Other information
42. It could be possible for the prospectus to include other sections and information at the discretion of the issuer, after the final prescribed sections.

INVESTMENT OVERVIEW

43. ASIC guidance states that a prospectus should contain an investment overview that helps retail investors make an informed investment decision by highlighting key information and containing a balanced treatment of the advantages and disadvantages.⁵ An overview could be useful, given that investors may focus on the first few pages of the document and the description of the risks may be found later in the document.

⁵ ASIC RG 228, at para 228.46.

Discussion questions

Assuming that headings are appropriate, are the above headings suitable? Would other headings be preferable?

Would an investment summary be a useful inclusion?

DETAILED CONTENTS

Discussion questions

Are the content requirements suggested below appropriate?

Are there alternative or additional content requirements that should be adopted?

Contents of section 1 (Timetable setting out the key dates in relation to the offer)

44. This section could include a timetable setting out the key dates in relation to the offer.

Contents of section 2 (About [name of issuer of the bond])

45. This clause could set out the content of section 2 of the prospectus. This could involve a brief description of the issuing entity and its business, the amount the entity intends to raise and the purposes to which the money will be put.

Contents of section 3 (How [name of product] works)

46. The text could include summary information on how the bond works and the nature of the rights and obligations that investors acquire.

47. In particular, section 3 could:

- include a summary of minimum [and maximum] investment amounts, if applicable;
- provide information on the structure of the scheme;
- state in general terms that the price of the bond may vary as interest rates fluctuate and the market value of the bonds rise or fall; and
- describe the frequency of interest payments and how they are calculated.

48. Specifically, section 3 could also include:

- the term and maturity date of the bonds;
- the amount being raised by issuing the bonds;
- the interest rate payable on the bonds;
- the dates for payment of interest on the bonds;

- the circumstances, if any, in which the bonds can be redeemed prior to the maturity date;
- a statement that the face value of the bonds will be repaid on the maturity date, subject to any early redemption events;
- a statement as to whether or not the bonds are secured or unsecured and what this means for investors in the bonds;
- the ranking of the bonds in relation to the other debt or proposed debt of the body issuing the bonds, together with a description of what this means for investors, in the event of a liquidation;
- the amount of other debt or proposed debt that would need to be paid in priority to the bonds, in the event of a liquidation;
- whether the issuer of the bonds may issue secured debt in the future or grant any security in relation to existing unsecured debt, the circumstances in which this may occur and what this means for investors;
- any guarantee of the issuer of the bonds' obligations in relation to the bonds and any significant limitations (including financial limitations) that apply to the guarantee;
- the voting rights of bondholders;
- the prescribed financial market on which the bonds will be listed; and
- if applicable, a statement that the retail corporate bonds are governed by a debenture trust deed and a brief overview of what this means for investors (not all bonds may require a trustee).

49. Information may also be provided on the buying and selling of the bond.

Contents of section 4 (Benefits of investing in [name of bond])

50. Section 4 could prescribe information on the benefits of investing in this particular bond including statements that:

- interest payments are regular (and non-deferrable and non-discretionary, if that is the case);
- the investment is for a fixed term (unless the investor decides to sell the bonds or if an early redemption event occurs);
- (as applicable) holders of the bonds rank higher than some creditors (for example, holders of ordinary shares), equally with some creditors and behind some creditors if the company becomes unable to pay all its debts; and
- the bonds may be sold on market prior to maturity.

51. The issuer may use the incorporation by reference mechanism (see below) to include additional information on the features and benefits of the particular bond or of retail corporate bonds in general.

Discussion question

Could section 4 be merged with section 3?

Contents of section 5 (Risks of retail corporate bonds)

52. This clause could provide for the contents of section 5 to address the risks of investing generally, as well as in retail corporate bonds. Specific statements need to be included noting that all investments carry risk, that different strategies may carry different levels of risk, and that assets with the highest long-term returns may have the highest level of short-term risks.
53. Section 5 could include a summary setting out the significant risks of the particular bond to which the prospectus applies. This could extend to risks to the issuer's business and any structural risks in relation to the bond (for example, if the bonds are subordinated, interest can be deferred or the term is very long).
54. Section 5 could also contain a number of statements addressing the key risks of investing in bonds generally, including that:
 - the value of investments will vary;
 - the level of returns will vary, and that future returns may differ from past returns;
 - returns are not guaranteed and investors may lose some of their money;
 - laws affecting retail corporate bonds may change;
 - the relevant level of risk for each investor will vary depending on a range of factors including their age, investment time frame, the investor's other investments and their individual risk tolerance; and
 - the issuer's credit may be affected by factors including business risk and operational risk.
55. The issuer could also incorporate by reference any further information it wishes to provide about significant risks or do so by including a reference to a website operated by or on behalf of the Commonwealth containing relevant information. This would not, however, detract from the requirement to provide a summary of significant risks. The prospectus could refer to ASIC's *MoneySmart* website or equivalent. At present, it is not possible to formally incorporate a third party's materials by reference – it is only possible to provide a 'mere reference' to third party materials.

Contents of section 6 (Summary of the financial position of the issuer of the retail corporate bond)

56. Section 6 of the prospectus could contain information on:
 - the purpose of the retail corporate bond issue;
 - the effect of the issue on the issuer of the retail corporate bonds, including details of the issuer's debt profile following the issue of the retail corporate bonds; and

- the capacity of the issuer of the retail corporate bonds to meet its obligations under the retail corporate bonds; and
- whether or not the issuer of the retail corporate bonds has breached any loan covenants or debt obligations in the two years prior to the date of the prospectus (other than those waived by the beneficiary of those covenants or obligations) and which are material to a consideration of an investment in the bonds; and
- if there has been a breach, the details of any breach or breaches which are material to a consideration of an investment in the bonds; and
- the key financial metrics of the issuer of the retail corporate bonds, including the issuer's gearing ratio, interest cover and working capital ratio, and an explanation about what the ratios mean to investors.

Discussion questions

Is it appropriate to require the inclusion of information on the capacity of the issuer to meet its obligations under the bonds? Would this require the issuer to provide forecasts which should not be required for bond transactions?

If ratios are to be included, should the formulae to calculate the ratios be prescribed and, if so, what formulae should be used?

If the abovementioned metrics are not useful given the nature of the issuer or the industry they are in, could the issuer be permitted to use other metrics?

Contents of section 7 (Summary of how the bonds are taxed)

57. Section 7 could describe in summary form the significant tax information relating to the bonds. It should also contain a warning about the consequences of failing to provide a person's Tax File Number.

Contents of section 8 (Summary of the interests of advisers and of any fees relating to the bonds)

58. Section 8 could set out:

- the nature and extent of interests that certain specified persons held in the issuer, property acquired or proposed to be acquired by the issuer, or the offer of the bonds; and
- amounts of money or benefits that have been paid or are to be paid to a director or a person providing services.

59. The persons specified are:

- any directors of the issuer;
- a person named in the prospectus as performing a function in a professional, advisory or other capacity in connection with the preparation or distribution of the prospectus;
- a promoter of the bonds; and

- an underwriter (but not a sub-underwriter) to the issue or sale or a financial services licensee named in the prospectus as a licensee involved in the issue or sale.

Contents of section 9 (Summary of how to apply for the retail corporate bond)

60. Section 9 of the prospectus could contain:

- the name and address of the body issuing the retail corporate bond; and
- the address of an Internet page, and a phone number, operated by or for the body issuing the retail corporate bond from which a person can obtain further information about the retail corporate bond.

Contents of section 10 (Other information)

61. Section 10 of the prospectus could contain the following information:

- a statement that, at the date of the prospectus, the issuer (or its listed parent company) has complied with:
 - Chapter 2M of the Act, as it applies to the issuer (or its listed parent company); and
 - section 674 of the Act;
- a statement that, as a disclosing entity:
 - the body (or its listed parent company) is subject to regular reporting and disclosure obligations; and
 - copies of documents lodged with ASIC in relation to the body may be obtained from, or inspected at, an ASIC office; and
- a statement that the following information is available, on the website maintained by the issuer and on a website maintained by the relevant market operator:
 - the most recent annual financial report of the issuer (or its listed parent company);
 - any subsequent half-year financial report lodged with ASIC before the lodgement of the prospectus with ASIC;
 - any continuous disclosure notices given by the issuer (or its listed parent company) to the relevant market operator after the lodgement of the annual financial report.

62. Section 10 could also contain any information about the offer that:

- has been excluded from a continuous disclosure notice in accordance with the listing rules of the relevant market operator to which that notice is required to be given by the issuer (or its listed parent company); and

- is information that investors and their professional advisers would reasonably require to make an informed assessment of:
 - the issuer’s assets and liabilities, financial position and performance, profits and losses, and prospects which are material to a consideration of an investment in the bonds; and
 - the rights and liabilities attaching to the bonds being offered.

Discussion questions

Would other content requirement reforms, be desirable, for example:

- A statement of general principles, including that the complexity of prospectuses is to be minimised, repetition is to be minimised and the focus of disclosure is on matters material to a consideration of an investment in the bonds;
- Inclusion of the terms of the bonds and the trust deed (if applicable) on the issuer’s website rather than in the prospectus;
- Inclusion of a summary of the tax consequences of the bonds for investors rather than a full opinion from a tax advisory firm;
- Requiring issuers to refer to other sources of information about themselves such as their Annual Reports and websites; and
- Publication by the Government, ASIC and other relevant bodies of relevant general information for investors, including in relation to the calculation and relevance of key ratios. Issuers could be required to refer to this independent information rather than to attempt to provide this advice to investors.

OTHER DISCLOSURES

63. Consistent with the ASIC vanilla bond relief, there could be a requirement that ongoing disclosure be provided in relation to certain matters – including quarterly reports under section 283BF (which has been modified to only apply to the issuer and any guarantor) and half-year and annual updates of key financial disclosures through their usual half-year and annual reports.

Discussion questions

Will retail investors benefit from reading these reports?

Also, should account be taken of the fact that not all bonds require a trustee and therefore not all bonds are subject to section 283BF?

USING A MULTI-PART PROSPECTUS

64. Under the reforms, issuers could also be able to offer qualifying bonds under
- a two-part prospectus, comprising a base prospectus (which could be used for several different offers) and a second part prospectus (which relates to the terms of a particular offer).
65. Together, the base prospectus and the second part prospectus would need to satisfy the content requirements for a retail corporate bonds prospectus.

MAXIMUM LIFE OF THE BASE PROSPECTUS

66. Consideration needs to be given to the maximum life of a base prospectus. Under the ASIC class order, the maximum life for a base prospectus is 2 years.⁶ The greater the maximum life of a base prospectus, the greater the potential advantage to issuers, who will be able to rely on the base prospectus for a number of issues over the life of the base prospectus. On the other hand, the greater the life of the base prospectus, the more likely it is to need to be updated.

DIVISION OF INFORMATION BETWEEN A BASE AND SECOND PART PROSPECTUS

67. As suggested by ASIC in Regulatory Guide 213, *Facilitating debt raising*, ideally: the base prospectus contains general information that is unlikely to change significantly over the life of the base prospectus and that relates to the issuer and the offers of bonds it may make in one or more second part prospectuses; and the information in the second part prospectus contains information that relates to a specific offer of bonds and the effect of that offer on the issuer.
68. Currently, neither the law nor ASIC guidance is prescriptive about the division of information between a base prospectus and a second part prospectus.⁷ However, an appropriate division might be as follows:
- The base prospectus could contain the information that is required to be included in a short form prospectus (including the terms of the bonds that are to be offered), but would not include:
 - the term, interest rate and interest payment dates of the bonds that are to be offered;
 - information relating to a particular offer of bonds (for example, the minimum subscription amount, offer size, issue price, the timetable and the application process);
 - certain key financial disclosures as follows:
 - : the purpose of the bond issue and the effect of the issue on the issuer, including details of the issuer's debt profile following the issue of the bonds;
 - : the issuer's capacity to meet its obligations under the bonds;

⁶ The maximum life for a 'standard' prospectus is 13 months (subsection 711(6)).

⁷ ASIC RG 213 *Facilitating debt raising* (May 2010), from RG 213.59.

- : the gearing ratio for the issuer, together with an explanation of what this means for investors and how investors can use the ratio to determine the level of risk;
 - : the interest cover for the issuer, together with an explanation of what this means for investors and how investors can use the interest cover to assess the issuer's ability to meet its interest payments;
 - : the working capital ratio for the issuer, together with an explanation of what this means for investors and how investors can use the ratio to determine the level of risk; and
 - : details of whether the issuer has materially breached any loan covenants or debt obligations in the two years prior to the date of the prospectus.
 - : information relating to the effect of the offer on the issuer; and
 - : any other information that must be included in a short form prospectus that is not known to the issuer at the date of issue of the base prospectus;
- The second part prospectus could contain:
 - details of the particular offering that have not been included in the base prospectus (for example, the interest rate, term, offer size and application process);
 - details of the effect of the offer on the issuer;
 - any information excluded from a continuous disclosure notice in accordance with the relevant market operators listing rules;
 - any supplementary disclosure necessary to update the information in the base prospectus; and
 - any other information that must be included in a short form prospectus that has not been included in the base prospectus.

69. An alternative suggested by some stakeholders would be to allow issuers who have issued a first tranche of bonds using a shorter bond prospectus to issue further tranches by publication of a term sheet and cleansing statement.
70. A term sheet could enable the issuer to simply outline the key terms of the new tranche of bonds, assisting with speed and ease to market. Basic information about the bonds, including the risks of investment in the bonds, would already been available through the initial shorter bond prospectus. This would be identical to the issuance of bonds in the wholesale market.
71. The cleansing statement could require the issuer to disclose any matters material to a consideration of an investment in the bonds which has not already been the subject of continuous disclosure. In this way, subsequent issues of bonds would benefit from a regime similar to that for rights issues (as foreshadowed in the Federal Government's December 2010 announcement). Examples of 'cleansing statements' or 'cleansing notices' can be found in sections 708A, 708AA, 1012DA and 1012DAA of the Act.
72. The initial prospectus would need to have a sufficiently long life to enable subsequent tranches to be issued, possibly as much as five years.

73. The cleansing statement could be in respect of matters material to a consideration of an investment in the bonds, not an equity investment.
74. The term sheet could contain:
- details of the particular offering (for example, the interest rate, term, offer size and application process); and
 - details of the effect of the offer on the issuer.

Discussion Questions

Do you agree with a two-part prospectus approach, or do you consider it would be preferable to have a prospectus followed by a term sheet and cleansing statement? What is the basis for your view?

What should be the maximum life of a base prospectus?

Is it feasible and/or appropriate to specify what information should be included in each part of a two-part prospectus, or alternatively in a short prospectus, term sheet and cleansing statement? If so, what should that content be?

INCORPORATION OF INFORMATION BY REFERENCE

75. It is proposed that the shorter prospectus may refer to other material located outside the prospectus document itself. This information may be incorporated by reference using the incorporation by reference (IBR) provisions for prospectuses. In this case the incorporated material is deemed to be part of the prospectus and the full range of prospectus liability and enforcement provisions apply. Information that is relevant but not key to an investor's assessment of the offer could be incorporated by reference. For example, the trust deed for the bonds could be incorporated by reference.
76. There could also be scope for the prospectus to refer to other information that is available in another separate document (known as referencing). This allows other information to be referred to without being formally incorporated. While the prospectus liability regime does not attach to referenced information which is not formally part of the prospectus, this information is still subject to requirements such as those against misleading and deceptive conduct in the Act and the ASIC Act. An example of this can be found in subregulation 5.C.2 (1E) of the Corporations Regulations 2001.
77. Given that not all potential customers may have access to the internet, simply providing a website link might mean that the incorporated material is not considered to be reasonably accessible. Therefore, the rules could require the inclusion of a telephone number in the prospectus which can be used to request a hard copy of the prospectus and any incorporated information.
78. A prominent warning could be required stating that: the short document is only a summary of key information; that certain important information may be located outside the prospectus document itself; and that persons considering investing in a retail corporate bond should read all of that information before making a final decision.

Discussion questions

Should there be scope to have information that is 'otherwise referred to', for example the issuer's annual and half-yearly reports, or information such as ASIC's *MoneySmart* website?

Should it be made clear what the effect of referring to such information will be since it does not form part of the prospectus (for example, could it satisfy prospectus content requirements even though there is no prospectus liability for this information)?

LIABILITY FOR PROSPECTUS CONTENT

79. In this section the focus will be specifically on directors' liability for prospectus content. It is assumed that the liability of the issuing company and of other involved persons raises no major concerns.
80. It is not proposed to make changes to liability for offers of other Chapter 6D securities, such as shares and complex bonds.

DIRECTORS' DEEMED CIVIL LIABILITY

81. Section 728 of the Corporations Act prohibits a person from offering securities under a disclosure document (for example, a prospectus) if, among other things, there is a misleading or deceptive statement, an omission of required material, or a new circumstance has arisen. It is a criminal offence for the issuer to contravene subsection 728(1) where the misleading or deceptive statement or the omission or new circumstance is materially adverse from the point of view of an investor (subsection 728(3)). However, subsection 728(3) does not extend to directors of the issuer.
82. Section 729 gives a person who suffers loss or damage because an offer of securities under disclosure documents that contravenes section 728 the right to recover the amount of loss or damage against a certain range of people who are itemised in section 729. These potential defendants include not only the company issuing the securities, but also directors of the security issuer, underwriters, and anyone else who contravenes or is involved in the contravention. Security issuers may be able to take advantage of the due diligence defence under section 731, and other defences contained in sections 732 and 733.
83. Stakeholders have indicated that the current liability regime is inhibiting issuance of corporate bonds to retail investors. Complying with the liability requirements adds extra expense, for example because deemed directors' liability entails a lengthy due diligence process by directors.
84. Accordingly, and given that the Government is providing specific content rules, it may be appropriate to remove directors' deemed liability for retail corporate bonds. Removing directors' deemed liability would be consistent with Council of Australian Governments (COAG) developments, noting that COAG has agreed there is a case for reform to promote a consistent and principled approach to the imposition of personal criminal liability for corporate fault (similar considerations apply to civil liability).

OTHER LIABILITY ISSUES

85. In addition, directors are required to consent to lodgement of a prospectus under Chapter 6D of the Corporations Act, which means that they are subject, effectively, to deemed liability for the whole document under sections 1308 and 1309. There is a 'reasonable steps' component of those provisions, but no other due diligence or reasonable reliance defence. As a result, removal of deemed civil liability may not of itself remove the need to involve the board in due diligence processes.
86. Some stakeholders have suggested that this liability could be removed, or that directors could be given the benefit of a 'safe harbour' or 'business judgement' rule. These arguments raise broader issues which would need to be considered in the context of directors' liability generally under the Corporations Act.

Discussion question

Should directors' deemed civil liability for prospectus content be removed?

EXEMPTION FOR PRUDENTIALLY REGULATED ENTITIES

87. At present, under subsection 708(19) of the Corporations Act, an entity that is an Australian ADI or that is registered under the Life Insurance Act 1995 is exempt from the disclosure requirements. The basis for this exemption is longstanding, and is related to the fact that ADIs are prudentially regulated. To ensure a level playing field between issuers, it may be appropriate to remove the subsection 708(19) exemption in relation to retail corporate bond issuance.
88. An alternative view is that subsection 708(19) should not be amended. Arguably, the benefits of subsection 708(19), including the ability for banks and insurance companies to issue certain types of fixed income securities without prospectus liability, quickly and easily, is the position that should ideally be achieved for all issuers. If subsection 708(19) was amended, this could weaken the impact of the reforms.

Discussion question

Should subsection 708(19) be amended in the context of these proposed reforms?

APPLICATION AND TRANSITIONAL ARRANGEMENTS

89. Appropriate application and transitional arrangements could be made at a later date which could take into account any need to give issuers sufficient time to comply with the new requirements (but also the fact that use of the shorter prospectus could be optional).

Discussion question

Is there a need for a transitional period and, if so, what should that period be?