

4 December 2009

Mr James Nott
Corporations
Australian Securities and Investments Commission

Email: debentures@asic.gov.au

Dear Mr Nott

**ASIC CONSULTATION PAPER 123 : DEBENTURES—
STRENGTHENING DISCLOSURE BENCHMARKS**

We welcome the opportunity to make submissions to the Australian Securities and Investments Commission (ASIC) on Consultation Paper 123: *Debentures—Strengthening the Disclosure Benchmarks* (CP123) dated October 2009.

We are a specialist law firm and our clients include a number of unlisted, unrated debenture issuers. The views expressed in this letter are, however, our own.

The objectives of the submission are as follows:

1. To question, in general terms, the aims behind the proposed amendments to the regime of disclosure against benchmarks on a “if not, why not” basis.
2. To raise some issues we consider flow from the amendments and their proposed application, and to provide suggestions to ASIC where appropriate.
3. To seek further guidance from ASIC in relation to certain issues.
4. To respond to some of the issues raised by the feedback questions in the CP123.

This submission does not, however, specifically respond to each of the feedback questions.

Section B: strengthening the benchmarks

B1Q1

Do you agree with this proposal? If not, please explain why.

We do not agree issuers should be required to exclude any amounts owing to the issuer from related parties or associates of the issuer from the calculation of “total equity” regardless of their nature. This is particularly so in circumstances where the recoverability of the loan is high because, for example, the loan is adequately secured. We recommend if loans owing from associates or related parties are to be excluded from the calculation of “total equity”, then only those loans which do not

meet certain criteria must be excluded. Reference should be made to the policy contained in ASIC regulatory guide 166 (RG 166) regarding the calculation of net tangible assets for responsible entities and, in particular, the policy in paragraph RG 166.72(a).

B2Q1

Do you agree with this proposal? If not, please explain why.

If additional disclosure will be helpful to retail investors (refer to our general comments), then we generally agree with this proposal.

B2Q2

Do you agree that a 20 percent reduction is an appropriate basis to measure the impact the difficult market conditions can have on cash flows?

We consider a range of rollover values based on historical averages for each issuer would provide a more realistic and appropriate basis upon which to stress test cash flows moving forward. While we note 20 percent is based on analysis of the impact of market volatility on rollovers during the global financial crisis (GFC), we suggest such volatility is unusual and as such may be an unrealistic basis on which to ordinarily base stress testing in the future.

B2Q3

Do you agree that three months is an appropriate timeframe against which to measure the impact of a 20 percent change in rollover or withdrawal rates on cash flows?

While we agree three months may be an appropriate timeframe for issuers which have frequent rollovers or those issuers who issue debentures on an “at call” basis, use of this period by other issuers who issue debentures with longer investment terms may not truly reflect cash flow stress.

We suggest the period to be used in stress testing should be a percentage of the weighted average of rollovers of an issuer for the preceding 12 months.

B3Q1

Do you agree with this proposal? If not, please explain why.

We suggest inclusion of the maturity profile of debentures and loans will increase the size and complexity of disclosure given to investors while not necessarily enhancing clarity or quality of information on which to make informed investment decisions.

Subject to our general comments, we have no objections to the proposal that the issuer should disclose the assumption about the level of rollovers the issuer has used in forecasting its cash flows and how this compares with historical rollover ranges. Equally, we have no objection to the proposal that issuers should disclose

the level of liquid assets maintained by the issuers under the terms of the debenture trust deed and/or the issuer's internal policies.

B4Q1

Do you think we should retain benchmark 4? If not, please explain why.

We agree with ASIC's proposal to remove the requirement to obtain a credit rating. The cost for issuers is prohibitive for smaller issuers and there is a lack of competition amongst the limited number of authorised providers.

B5Q1

Do you agree with these proposals? If not, please explain why.

We agree with the proposal to provide a definition of "in arrears".

We also suggest further clarification is given to what constitutes "legal proceedings". For example, is a letter of demand "legal proceedings"? Is the appointment of a receiver "legal proceedings"?

We question the value to investors of being provided with information about the interest margin received by issuers.

The information which ASIC proposes to include in prospectuses for debenture offers is likely to change frequently over the 13-month life of a prospectus. ASIC should therefore permit an issuer to include such information on its website or in some other manner which is easily accessible by investors. It is arguable that any loan which is in default and has not been disclosed by way of a supplementary or replacement prospectus might be materially adverse from the point of view of an investor. In this regard, we recommend ASIC considers giving relief to offers made under chapter 6D similar to the relief contained in ASIC class order 03/237, but expanding that relief to permit information such as loan defaults and arrears, which might be materially adverse from the point of view of an investor, to be provided via an issuer's website rather than through provision of replacement or supplementary prospectuses.

B7Q1

Do you agree with this proposal? If not, please explain why.

Falling asset prices due to the GFC have affected every industry and asset class. If ASIC takes the same approach to other industries, such as the mortgage fund and property funds industry, in the way loan to valuation ratios are to be calculated, then there is a greater argument the proposed approach for debenture issuers would be fair and reasonable.

C1Q1

Do you agree with this proposal? If not, please explain why.

We do not consider this proposal will promote investor understanding. We consider the proposal will add further complexity and length to disclosure documents and therefore will not assist investors understand the risks associated with a particular product.

In addition, is it the product issuer's obligation to educate the investor generally about a particular product or industry? The kind of disclosure which ASIC is considering an issuer include in its disclosure document goes beyond the general disclosure test in the law to include information that investors and their professional advisors would reasonably require to make an informed assessment of the rights and liabilities attaching to the debentures of the issuer and the assets and liabilities, financial position and performance, profits and losses and prospects of the issuer.

C1Q2

Should the additional disclosure only be provided by issuers that have not met particular benchmarks? If so, please explain why.

As outlined above, we do not consider additional disclosure will promote investor understanding. We consider alternative methods of investor disclosure would be more useful, as outlined below.

C1Q4

Do you have any additional or alternative suggestions to improve investor understanding of the benchmarks?

We consider the best method of increasing investor understanding of the benchmarks, and debentures more generally, is to require issuers to disclose a link to a dedicated debenture information site on ASIC's website. Use of such a site would allow investors to receive up to date and useful information on the risks involved in investing in debentures, including the investor guide, trends, statistics and other consumer information provided by ASIC.

D1Q1

Do you agree with this proposal? If not, please explain why.

We agree with the discontinuance of the interim no action position set out in report 38 in relation to when issuers can describe or refer to their products as "debentures".

General comments

In ASIC's submission to the PJC inquiry into financial products and services in Australia, ASIC states that "disclosure is unlikely to be effective if investors are not engaged, do not have sufficient levels of financial literacy or access to advice"¹.

Therefore, we query why it would assist retail investors in making better decisions about how to invest their money to compel issuers to provide further and more detailed disclosure if there is, as ASIC states, evidence that some retail investors do not read disclosure documents, or if they do read them, do not understand them². We fail to understand how the production of longer and more complex disclosure documents about debenture products is going to assist retail investors if they are not currently read and understood.

In addition, we query whether the proposals contained in CP123 will better promote investor understanding of debenture products. Have the proposals been consumer-tested? That is, has ASIC given disclosure documents to investors which do not contain the enhanced disclosure features proposed in CP123 and then a disclosure document which does contain the enhanced disclosure, to test whether an investor's understanding actually improves? Given the kind of further disclosure which is proposed under CP123, we query whether this will have any benefit in assisting a retail investor understand debenture products, if as ASIC says, disclosure is not going to be effective unless investors are engaged, have sufficient levels of financial literacy or access to advice.

In addition, further benchmark disclosure appears to be at a cross purpose with the Financial Services Working Group's current project into reducing the length and complexity of disclosure documents. In our view, the proposals contained in CP123 are sending mixed messages to the industry about whether, for disclosure to be effective, it should be more concise, or more detailed.

If you have any questions in relation to our submission or would like to discuss it further, then please contact me.

Sincerely



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Partner

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¹ Paragraph 206 ASIC submission to the PJC inquiry into financial products and services in Australia.

² Paragraph 205 ASIC submission to the PJC inquiry into financial products and services in Australia.