



4 March, 2014

Mr Jason McNamara
Executive Director
Office of Best Practice Regulation
Department of the Prime Minister and Cabinet
1 National Circuit
BARTON ACT 2600

Dear Mr McNamara

SINGLE-STAGE REGULATION IMPACT STATEMENT- FOR ASSESSMENT

I am writing in relation to the attached final single-stage Regulation Impact Statement (RIS) prepared by Treasury for the proposal to reduce the regulatory burden when issuing simple retail corporate bonds.

I note that Treasury has prepared a single-stage RIS, and as no decision has been previously announced, an options-stage RIS was not required.

I am satisfied that the final single-stage RIS addresses the issues raised in your letter of 3 February 2014, in particular that the RIS:

- more clearly explains the current arrangements and outlines the differences from both a compliance and investor protection perspective;
- provides more balance and depth to the discussion of the problem with the current arrangements;
- provides more depth to the discussion of why the current regime deters the issuance of retail bonds; and
- provides a more detailed explanation of stakeholder views on the various options.

Attachment A to this letter details where the RIS has been amended to address the specific questions raised by the Office of Best Practice Regulation (OBPR). Also, I note that the OBPR has agreed with the regulatory cost estimates provided in the RIS. Accordingly, I am satisfied that the final single-stage RIS now meets the Government's best practice regulation requirements.

I submit the RIS to the OBPR for formal assessment.

Yours sincerely

A handwritten signature in cursive script that reads "J. Wilkinson".

Jenny Wilkinson
Acting Executive Director
Markets Group
Treasury

Attachment A

Treasury's responses to issues raised by the OBPR on the 1" pass RIS

The following attachment addresses the problems identified in Attachment A of OBPR's letter of 3 February 2014.

Problem

OBPR issue

1. To our reading the status quo is unclear. The RIS mentions that issuers of simple retail corporate bonds are eligible for disclosure relief from ASIC provided certain conditions are met. While we understand from our discussions that the key difference relates to director's liability, this is not clear on the face of the RIS as drafted. Therefore, it would be useful for the document to consider:
 - a. How is the current relief provided by ASIC different from the proposed changes?
 - b. Are there different conditions that entities must meet to issue the simpler prospectus?
 - c. To what extent is the director's liability framework thought to have influenced behavior? Have there been any cases taken by ASIC?

Treasury response

Treasury has expanded the Problem section to provide more details on the relief provided by ASIC Class Order CO 10/321 (page 5 and page 10). The RIS also notes that two-part prospectuses will provide greater certainty for investors. Further comparison is made between the current relief and the conditions under Option 1 (page 8).

The RIS notes that disclosure relief provided by CO 10/321 has not made retail bond issuance attractive to corporate entities, and that only two retail bond issues have been made utilising disclosure relief since the CO 10/321 came into effect (page 4).

In addition, the RIS sets out the criteria a bond must meet for the simple retail corporate bond prospectus to apply (page 10).

On the subject of directors' liability framework, the amended RIS outlines the disincentives that exist under the current regime. The RIS refers to industry submissions that have raised concerns with the current liability framework, and provides statements from industry as to its deterrence effect (page 5).

OBPR issue

2. It would also be useful for the RIS to explain why it is considered inappropriate to continue to rely on ASIC's class order. What are the views of ASIC and Corporations on the efficacy of the class order?

Treasury response

The Problem section has been expanded to provide further details on the inadequacy of disclosure relief provided by Class Order CO 10/321. As noted earlier, only two retail bond issues have been made utilising disclosure relief since the Class Order came into effect. The RIS provides an example of one of the issues being costly and time consuming due to the bond issuer's uncertainty about what the prospectus needed to include (page 4) and refers to industry views on the class order's efficacy (pages 5 and 10).

OBPR Issue

3. It is also unclear to us what the extent of demand is from corporations to issue simple retail bonds. For example, the RIS mentions that only two issuers have made offers of bonds relying on ASIC's relief.
 - a. Does this suggest that there is limited demand to issue simple bonds? Or do other factors, such as administrative complexities, explain why few simple bonds are issued through this relief?
 - b. Have stakeholders provided an indication of the extent to which they would increase their issuance of simple bonds under the RIS's preferred option?

Treasury response

The amended RIS clarifies that administrative complexities are responsible for the limited issuance of retail corporate bonds. References to industry submissions and targeted consultations support this point (pages 3, 4 and 5). The RIS notes that one corporate entity intends to issue retail bonds as soon as Option 1 is put into effect, and refers to industry expectations about the number of issuances over a one-year and ten-year period (page 14).

OBPR issue

4. In its current form, the draft RIS requires more balance in defining the scale, scope and nature of the problem. We understand from discussions with your office that at present, bond issuers find it prohibitively expensive to issue retail bonds, but that they have available to them other viable options of securing funding. We understand further that while some industry members have expressed strong interest in issuing such bonds, numbers of issues are small and predicted to rise to a modest amount over the 10 year period over which the impacts are assessed. Accordingly, we suggest that the statement of the problem be revised to make it clear the relative scale and scope of the problem. Some suggestions on how this might be achieved include:
 - a. The discussion in the introduction focusses on the issuance of bonds as the key means of businesses raising funds from investors. This may tend to overemphasise the significance of any weakness in the bond market. The problem statement would benefit from additional context about other means of raising funds (eg. equity). Put another way, why is the supposed weakness in the retail bond market such a problem when corporations can raise capital via wholesale bond markets, direct borrowing or equity raising?
 - b. The problem statement refers to Australia having a relatively 'weak' bond market. The RIS should explain what is meant by weak (i.e. lack of trading /liquidity, lack of volume, etc.) and illustrate this by reference to some objective benchmarks (ie. statistical comparisons with other jurisdictions may be helpful in this regard).
 - c. Given the high level of superannuation funds in the institutional investment market, it is unclear why the (relatively less regulated) wholesale bond issuance market is not sufficient to meet the needs of the sector, particular those who are reluctant to issue retail bonds. The RIS would benefit from further discussion about the degree of substitutability on the corporate debt issuance side and why the wholesale market is inadequate in this regard.
 - d. The problem statement asserts (on page 4) that cost as well as potential civil and criminal liability deter corporations from issuing retail bonds. This statement requires further substantiation.
 - i. Is this based on consultation with potential issuers?
 - ii. Does the reference to potential individual liability accord with evidence of prosecutions of directors for misstatements in prospectuses in relation to retail bond issuance?
 - iii. What is the current state of the market in terms of disclosure and misleading statements/omissions by directors/issuers? Is this seen as being optimal?

Treasury response

Treasury has expanded the Problem section to provide further information and greater context on the capital-raising options available to corporate entities in Australia. In particular, the RIS discusses substitutability between the retail and wholesale bond markets (pages 3 and 4). This point is also discussed where the RIS examines the costs and benefits of Option 1 to retail investors (page 17).

The RIS refers to ASX data and the Johnson Report, which highlights the relative weakness of Australian retail corporate bond market (pages 2 and 3).

The RIS's statement that potential civil and criminal liability deters corporations from issuing retail bonds is supported by industry submissions (page 6).

The RIS notes that as far as Treasury is aware that Issuers of corporate bonds have not been prosecuted for misstatements in relation to retail corporate bonds.

Objectives

OBPR issue

The objective as currently drafted is pre-emptive in that it appears to focus only on options to develop the (implicitly, retail) corporate bond market in Australia.

4. The objectives section should be redrafted such that it is capable of encompassing a range of options to facilitate corporate debt issuance, or capital-raising more generally.

Treasury response

The Objective section has been amended to frame the development of Australia's retail corporate bond market within the wider objectives of increasing the sources of funding available to businesses, increasing investment opportunities for retail investors, and developing Australia as a leading financial centre (page 6).

Options

OBPR issue

5. The discussion of offer-specific prospectuses should include a more detailed analysis of why the inclusion of these categories of information are likely to be substantially less complex/costly to comply with than the current regime.

Treasury response

The RIS has expanded the discussion on disclosure to outline the reduced complexity and costliness of issuing offer-specific prospectuses (page 8). The RIS presents a rationale on why the criteria of simple bond prospectus has been proposed (page 9). The RIS notes that under Option 1 issuers will have more confidence that they are able to comply with disclosure requirements, than with the requirements of ASIC Class Order CO 10/321 (page 9).

OBPR issue

6. The discussion of the Johnson Report recommendations should clarify what is meant by 'high quality debt' and how such as distinction might be administered in practice.

Treasury response

The RIS provides a short explanation of what constitutes 'high quality corporate debt' in a footnote (page 7).

OBPR issue

7. The discussion of continued liability for directors or other persons involved in misleading or deceptive statements or omissions should clarify what is meant by 'involved'. Similarly, a more detailed discussion of the requirement to take 'reasonable steps' to ensure the accuracy of information would provide useful context for the impact analysis, particular in relation to the assessment of impacts on retail investors.

Treasury response

Treasury has clarified the terms 'involved' and 'reasonable steps' (page 10 and 11).

OBPR issue

8. The discussion of Option 3 should provide a brief discussion of which investor protections will remain in place and the procedures that companies will continue to go through to issue retail debt, and the extent to which this will inform market transparency and confidence.

Treasury response

The RIS now provides a brief discussion of investor protections that will remain in place under Option 2 (note that Option 3 leaves the regulatory settings unchanged) (page 12). The RIS lists the information that will be available to retail investors (page 13). This point is expanded on when the RIS notes that penalties for misleading and deceptive conduct and other relevant breaches of the Corporations Law will remain in place (page 18). In terms of market transparency and confidence, the RIS now observes that while information about the issuer will be available to retail investors under Option 2 (due to financial statements, annual reports and continuous disclosure requirements), this information will not be readily available to retail investors, nor specific to the bonds on offer (page 12). The RIS raises the possibility that increased investor caution may limit the development of Australia's retail corporate bond market (page 18).

Impact Analysis

OPBR issue

9. The impact analysis currently references wholesale markets and financial institutions as alternatives for retail bond issuance. This should also include equity-raising and assess the incremental benefit of reducing costs of retail bond issuance. It may be illustrative to include a comparison between current aggregate levels of direct debt, wholesale bond, retail bond and equity capital-raising.

Treasury response

Under Option 1, Treasury expects that a stronger retail corporate bond market will reduce the cost of borrowing on the wholesale market, borrowing through the banking sector, and raising equity (page 13). A table comparing capital-raising costs is provided (page 3).

OBPR issue

10. The discussion of Option 1 states that retail investors are not likely to face any increased costs or risks due to this proposal. This claim would benefit from greater balance or substantiation. In particular, more detailed analysis is required on what information is currently provided (or required to be provided) to retail investors that would be removed under the proposed option. It should then examine the particular risks to which retail investors may be exposed due to this, as well as how this proposal is likely to influence behaviour by both retail investors and directors/issuers.

Treasury response

The information that is provided to retail investors under the current regime has been included (page 4), and the information that would be provided under Option 1 is also included (pages 8 and 9). Treasury considers that the targeted nature of disclosure under Option 1 will benefit retail investors.

Treasury has emphasised that bonds issued to retail investors will be limited to low-risk simple bonds. Furthermore, only listed companies may issue bonds under Option 1, meaning that issuers will be subject to continuous disclosure requirements. Given these conditions, Treasury does not expect that retail investors will face significant risks under Option 1. The only protection lost is the right to claim compensation from directors when an investor suffers loss or damage (page 17).

OBPR issue

11. The discussion of Option 2 implicitly assumes that Government regulation is the only way to ensure information is provided to debt markets. The discussion of this option should examine whether, in the absence of any Government-mandated information provision, private ordering or market forces may prompt disclosure or rating of debt products that would provide some information to the market.

Treasury response

The RIS provides details on the information commonly provided to wholesale investors through the continuous and periodic disclosure obligations of being listed on the ASX (pages 11, 13- 14). The RIS also raises the possibility that increased investor caution (due to a lack of readily available information) may limit the development of Australia's retail corporate bond market (page 17).

OBPR issue

12. The discussion of default risk (page 14) should include an assessment of the seriousness of this risk, if possible by reference to information on the number and magnitude of defaults that have occurred in the past.

Treasury response

The RIS notes that- as far as Treasury is aware- there has been no default in repayments by a corporate bond issuer in Australia (page 17).

OBPR issue

13. The discussion of the benefit of Option 2 to retail investors should, in the interests of balance, give greater emphasis to any transparency provided to the market by existing disclosure requirements.

Treasury response

The RIS provides information on existing disclosure requirements (page 9).

Compliance costs

OBPR issue

14. The OBPR will require substantially more information regarding the underlying assumptions and figures used to estimate the compliance costs in order to agree the castings. These assumptions should be stated transparently in the RIS.

Treasury response

As no corporate entities intend to issue retail bonds under the current regime, there will be no change in compliance costs (page 14).

OBPR issue

15. The compliance costs savings should be calculated based only on the avoided, direct or administrative costs associated with complying with the retail bond issuance requirements. Other economic or financial costs- for example, lower cost of debt issuance due to higher demand- should be excluded from the compliance costs calculations (but should be discussed in the general impacts analysis).

Treasury response

The discussion of compliance costs has been updated using this methodology (page 14).

OBPR issue

16. Compliance castings are required to be agreed with the OBPR prior to the submission of the certified, second-pass RIS for formal assessment.

Treasury response

Agreed.

Consultation

OBPR issue

17. The consultation section should include a more detailed account of stakeholder feedback, including by key categories. For example, what were the key points raised by directors/issuers and what is Treasury's assessment of these views? What were the key concerns of investor groups and are they warranted in light of the existing and proposed regulation and existing standards of market conduct

Treasury response

Treasury has expanded the Consultation section and included a more detailed account of stakeholder feedback. The RIS now makes reference to an investor group submission which supported the proposal (pages 19-21).

OBPR issue

18. In general, RISs are expected to follow the two-stage RIS process. This is preferable as it provides greater opportunity for consultation on the detail of the proposal. The RIS as currently drafted notes simply that the single-stage RIS was prepared as no decision had been announced. In addition to requiring that no decision has been announced, the RIS Guidelines require that a reason be stated for undertaking a single-stage RIS (e.g. the proposal is urgent or straightforward).

Treasury response

Treasury has provided a rationale for the single-stage RIS (page 19).

Conclusion

OBPR issue

The conclusion (Recommendation) as currently drafted appears to support the proposed option based primarily on the level of industry support. The conclusion should include a more balanced and detailed weighing up of the costs and benefits of each of the proposals, including the potential risk to investors and long-run impacts on investor confidence. It should include more detailed analysis to enable the reader to understand why the proposed option is seen as providing the greatest net benefits, taking into account the full range of compliance cost savings, economic benefits and risks.

Treasury response

Treasury has amended the Conclusion section to provide a more balanced discussion of the costs and benefits to both industry and retail investors. In particular, Option 2 is rejected because Treasury considers that the provision of information to retail investors will be inadequate. Furthermore, the lack of freely available and relevant information under Option 2 is likely to reduce investor confidence, and limit growth in the market (page 22).

*Implementation and Review***OBPR issue**

The implementation and review section should provide more information on the proposed timing of the changes, including any transitional period.

Treasury response

The timing of this proposal, and the nature of any transitional periods, has been included (page 23).