



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 69

Debentures—improving disclosure for retail investors

August 2008

About this guide

This guide is for issuers and others involved with the issue of debentures.

It sets out guidelines for improved disclosure to retail investors to help them understand and assess these debentures, while maintaining the flexibility of the public fundraising process.

See also Regulatory Guide 156 *Debenture advertising* (RG 156).

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This version was issued on 29 August 2008 and is based on legislation and regulations as at 29 August 2008.

Previous version:

Superseded Regulatory Guide 69, issued in October 2007.

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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A Overview

Key points

The risk features of debentures and their appeal to ordinary retail investors require an improved approach to disclosure: see RG 69.1–RG 69.3.

ASIC has developed 8 benchmarks that can help investors understand the risks, assess the rewards being offered and decide whether these investments are suitable for them: see RG 69.4–RG 69.5.

Issuers of unlisted debentures should address the benchmarks in their disclosures on an ‘if not, why not’ basis and ensure that their advertising is consistent with these disclosures: see RG 69.6–RG 69.7.

Those involved with issuers (e.g. trustees, auditors and valuers) should use the benchmarks and the ‘if not, why not’ explanations in carrying out their responsibilities: see RG 69.8.

Our approach to unlisted debentures

- RG 69.1 Debentures held by retail investors are used as a source of finance for a range of business models and activities. With debentures, the investor provides loan funds to the issuer, and in return the person borrowing the funds (the issuer) issues a debenture with a promise to pay a rate of interest (usually fixed) for a defined term, and then repay the loan.
- RG 69.2 Some features and risks common to debentures and their issuers can create risks for investors. This is particularly the case for debentures that are not listed on a public market (‘unlisted’ debentures): see Section B of this guide. A lack of clear benchmarks can also make it hard for investors to adequately understand, assess and compare these securities.
- RG 69.3 ASIC has identified 4 guiding principles for improved disclosure by issuers of unlisted debentures that are designed to provide for better risk assessment by retail investors: see Table 1. These principles are the foundation for our approach in this guide.

Table 1: Guiding principles for improved disclosure on unlisted debentures

What the principle is	Related information
Principle 1: Benchmarks can help retail investors assess the risk and risk-reward prospects of debentures.	See Section C of this guide
Principle 2: Issuers of unlisted debentures should include these benchmarks in their disclosures on an ‘if not, why not’ basis and ensure that their advertising is consistent with these disclosures.	See Section D of this guide and Consultation Paper 94 <i>Debenture advertising</i> (CP 94)

What the principle is	Related information
<p>Principle 3: Those involved with issuers (e.g. trustees, auditors and valuers) should use the benchmarks and the ‘if not, why not’ explanations in carrying out their responsibilities.</p>	See Sections E–F of this guide
<p>Principle 4: Additional education will assist investors and potential investors in the unlisted debentures sector, including by helping them understand and use the benchmarks and the ‘if not, why not’ responses in their investment decision making.</p>	

Benchmarks for unlisted debentures

- RG 69.4 ASIC has developed 8 benchmarks that apply to unlisted debentures: see Table 2 and Section C of this guide. Some benchmarks apply to all issuers; others apply only to certain issuers. We expect the benchmarks to be followed (as applicable) and if not followed, explained on an ‘if not, why not’ basis: see RG 69.6–RG 69.7. We also expect any advertising to support the use of these benchmarks: see Consultation Paper 94 *Debenture advertising* (CP 94).
- RG 69.5 Failing to meet one or more of these benchmarks does not mean that a particular debenture is necessarily a poor investment; however, additional disclosure to investors will be needed to address that benchmark on an ‘if not, why not’ basis so that investors can assess its impact on their investment decision.

Table 2: Benchmarks for unlisted debentures

General benchmarks for all issuers of unlisted debentures	1 Equity capital	Benchmarks 1 and 2 address the issuer's financial structure and ability to meet loan obligations on time.
	2 Liquidity	
	3 Rollovers	Benchmark 3 addresses the transparency of the issuer's approach to ‘rollovers’ of investments.
	4 Credit ratings	Benchmark 4 creates incentives for ratings provided by experts in assessing credit risk.
Additional benchmarks for lenders	5 Loan portfolio	Benchmark 5 addresses the issuer's lending practices.
	6 Related party transactions	Benchmark 6 addresses a specific area of lending risk.
Additional benchmarks for property-related debentures	7 Valuations	Benchmarks 7 and 8 address the issuer's property-related practices.
	8 Lending principles—loan-to-valuation ratios	

Disclosure against the benchmarks—‘If not, why not’

- RG 69.6 Issuers of unlisted debentures should address the benchmarks in their disclosures on an ‘if not, why not’ basis: see Section D of this guide. This means stating that the issuer and product either:
- (a) meet the benchmark; or
 - (b) do not meet the benchmark *and* explaining how and why the issuer deals with the business factors or issues underlying the benchmark in another way.
- RG 69.7 Disclosure against the benchmarks should be:
- (a) addressed upfront in the prospectus;
 - (b) updated in ongoing disclosures as material changes occur, for example:
 - (i) in a replacement prospectus, supplementary prospectus or continuous disclosure notice; and
 - (ii) at least twice a year, in quarterly reports to trustees; and
 - (c) supported in, and not undermined by, advertising material.

Other participants involved with unlisted debentures

- RG 69.8 We expect other parties involved with issues of unlisted debentures to support the guiding principles in Table 1: see Sections E–F of this guide. This includes trustees, auditors and valuers.

Next steps

Who does this apply to?

- RG 69.9 We expect issuers of unlisted debentures to follow the guidance and expectations in this guide. In accordance with our Consultation Paper, we do *not* expect issuers of listed debentures to follow the guidance and expectations in this guide.
- RG 69.10 At this stage, we do *not* intend to apply the guidance and expectations in this guide to those issuers of debentures that were rated (by a recognised credit rating agency) before Consultation Paper 89 on unlisted, unrated debentures was released in August 2007. The debenture sector, and the significance of the debentures being listed or rated, is discussed in Section B of this guide.

Note 1: Consultation Paper 89 *Unlisted, unrated debentures—Improving disclosure for investors* (CP 89) was issued on 23 August 2007: see www.asic.gov.au/cp. CP 89 focused on unlisted, unrated debentures. While a credit rating provides some external scrutiny of a debenture issuer, we do not believe this of itself is sufficient substitute for the improved and enhanced disclosure against the benchmarks, at least for newly-rated debentures. Over the coming months, we will be discussing the potential application of this guide to debentures rated before CP 89 was released in August 2007.

Note 2: This guide does not apply to initial public offerings under a prospectus that states that the offered debentures are to be quoted on a financial market. This guide will apply if that prospectus is varied by supplementary or replacement prospectus indicating withdrawal of the intention to quote the debentures on a financial market. For further information see Regulatory Guide 99 *Disclosure documents and PDS: quotation of securities and financial products* and s723(3) of the *Corporations Act 2001* (Corporations Act).

Note 3: This guide does not apply to any debentures that are convertible into listed securities at the discretion of the investors.

What is the timing?

RG 69.11 New issuers must disclose against the benchmarks in new prospectuses from 1 December 2007. We also expect them to refer to the benchmarks in their ongoing disclosures from that time.

RG 69.12 Existing issuers have until 1 March 2008 to specifically report against the benchmarks to their existing clients by either:

- (a) issuing a replacement or supplementary prospectus; or
- (b) lodging a continuous disclosure notice with ASIC.

We also expect existing issuers to refer to the benchmarks in any new prospectuses and in their ongoing disclosures from 1 March 2008 on an ‘if not, why not’ basis.

RG 69.13 We will review updated investor disclosures and quarterly reports for each issuer in this industry sector in the period to June 2008 to check that this benchmarking information is adequately disclosed to investors on an ‘if not, why not’ basis.

RG 69.14 During this period we will also:

- (a) work with issuers and trustees to ensure that the benchmarks and our disclosure expectations are understood;
- (b) discuss any concerns we have with an issuer’s disclosure with them and, where necessary, require additional disclosure (e.g. about the practical impact of not following a particular benchmark and the associated risks for investors);
- (c) discuss any concerns we have about the financial position and performance of an issuer with the issuer and trustee;
- (d) consult with industry on the application of this guide to established rated debentures; and
- (e) conduct surveillance visits as needed to reinforce our disclosure expectations.

Table 3: Next steps in implementing improved disclosure

From 1 December 2007	New fundraising documents from new issuers comply with ‘if not, why not’ benchmarks
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1 December 2007 to 1 March 2008	Existing issuers report against benchmarks to existing investors
From 1 March 2008	New fundraising documents from existing issuers comply with 'if not, why not' benchmarks
1 December 2007 to June 2008	ASIC reviews fundraising documents and reports against the 'if not, why not' approach
June 2008	ASIC issues public report on the results of the new approach

Underlying principles

- RG 69.15 The disclosure framework in the Corporations Act requires issuers of financial products who seek retail investors to:
- (a) disclose upfront to these investors all they need to know to make prudent decisions in their own interest; and
 - (b) provide ongoing disclosure to help retail investors monitor whether their expectations are being met.
- Note: For such debentures, the framework provides an additional safeguard by requiring that there be a trustee for debenture holders: see Section E.
- RG 69.16 If the funds invested in failed unlisted debentures were raised in professional markets or provided by professional investors, their commercial failure would be of less concern to ASIC or the broader community. In an open economy such as that in Australia, business failure is accepted as an inevitable result of a competitive environment.
- RG 69.17 What is of concern is the combination of the risk features of these types of investments (see Section B) and their appeal to ordinary retail investors.
- RG 69.18 The regulatory framework places special emphasis on the needs of retail investors, and makes disclosure the key tool for them. Disclosure is not designed to stop retail investors from taking investment risks, but to help them understand the risks involved in any particular investment or type of investment. This enables them to make an informed decision about whether the potential reward (the return on their investment) matches the level of risk involved, and whether they are prepared to take on that risk.
- RG 69.19 This assessment is particularly important and difficult if investors need to consider not only underperformance risk (the risk that an investment will not produce returns as high as expected), but also the risk of significant or total loss of the original investment funds. For debentures, typically the return is fixed because the issuer promises to pay interest on the loan at a fixed rate. So the issuer's ability to repay the funds lent (credit risk) is usually the most critical risk.

- RG 69.20 We believe that our approach balances:
- (a) the need to improve disclosure to allow investors to make informed decisions; and
 - (b) the desirability of not unduly interfering with this market as a market for raising capital.

Note: The need to strike an appropriate balance between protecting investors' interests and allowing markets to operate freely is part of ASIC's mandate under the *Australian Securities and Investments Commission Act 2001* (ASIC Act). It is also reflected in the Government's Statement of Expectations and ASIC's Statement of Intent. These documents were published in August 2007.

- RG 69.21 Our approach cannot prevent investments failing, nor ensure that they perform to investors' expectations. However, better disclosure can help investors make better risk–reward decisions.
- RG 69.22 Our approach should not result in longer disclosures. Recent experience shows that investors need better quality and relevant disclosure, presented in a way best suited to investor understanding.
- RG 69.23 In developing our approach, we have reviewed relevant international developments (including the approach taken to similar products in the United States and New Zealand). Over the coming months, we will also be considering whether a similar approach is appropriate for any other sectors, including some managed investment schemes.

B The unlisted debenture sector

Key points

Debentures held by retail investors are used as a source of finance for a range of business models and activities: see RG 69.24–RG 69.25.

Some features of unlisted debentures and their issuers can create risks for investors: see RG 69.26–RG 69.28.

A lack of clear benchmarks can make it hard for investors to adequately understand and assess these products: see RG 69.32–RG 69.34.

Business models and activities

- RG 69.24 Capital markets provide funds to enable companies in the real economy to innovate and take commercial risks without certainty of return.
- RG 69.25 Debentures held by retail investors are used as a source of finance for a range of business models and activities and have been part of capital markets for a long time. Uses of capital raised in this way include:
- (a) *debt capital funding*—money raised and applied as working capital or transaction-specific funding to further the issuer or group’s business operations;
 - (b) *finance*—lending for personal and general commercial purposes;
 - (c) *integrated property*—funding of property transactions and development within a group or with related parties where that amount of funds applied is greater than 10% of total assets of the debenture issuer;
 - (d) *mortgage financing*—secured mortgage lending for residential and commercial property ownership and improvement with security over real property;
 - (e) *structured real estate investments*—participation in ownership of commercial and residential real estate as part of a wider ownership structure; and
 - (f) *memberships*—debentures issued to facilitate membership of clubs, groups, or franchise operations.

Risks to investors

- RG 69.26 In recent years, there have been a number of market failures in the debenture sector, particularly with unlisted, unrated debentures. A large number of investors face potential losses of significant amounts of money.

- RG 69.27 We have analysed the common features of those failures and recent failures in the debenture sector in New Zealand (as well as one recent non-debenture failure in Australia, the Westpoint Group). This analysis has identified the key features and risks common to those failed entities: see Table 4.
- RG 69.28 These features are not present in every issue of debentures to retail investors. The investment risks described will vary from issuer to issuer and from business model to business model. However, disclosure about these features and risks, including to what extent they are present in a given offering, is desirable for a broad range of debentures.

Table 4: Common risk features of unlisted debentures

Risk feature	Description	What this means
Minimal equity capital	The debenture issuer frequently has little equity capital relative to the loan funding it relies on to operate its business (loan funds includes both funds borrowed from a lending institution and funds contributed by debenture holders).	The owners of the entity that issues the debentures have little capital at risk compared to debenture holders and other lenders. This arguably means they have less incentive to ensure the prudent management of the business, and also that their interests and those of debenture holders are not well aligned. If an investment runs into difficulties, there is no source of funds to tide the investment over, other than by raising further investment funds.
Liquidity	The liquidity of the issuer is key to its ability to meet its obligations to pay interest and principal to debenture holders on time.	Liquidity is often at risk because of a mismatch between the timing of the issuer's obligations to repay debenture holders, and the timing of cash flows from the underlying businesses or assets to which funds have been on-lent. Liquidity is frequently heavily dependent on continuing inflows from new investors, or 'rollovers' by existing investors. This problem is exacerbated if inadequate disclosure in a prospectus leads to ASIC halting further fundraising by issuing a stop order. The issuer can then no longer rely on an inflow of funds from new investors. This may worsen its liquidity and in extreme cases threaten its solvency.
Loan assessment and diversification	The criteria issuers use to decide what loans to make are extremely variable and prone to risk, especially in these key areas: <ul style="list-style-type: none"> • loan-to-valuation ratios are often much higher than for traditional lending; • the loans issuers make may be highly concentrated to particular types of assets, commercial activities, locations or borrowers. 	In many cases the debenture issuer's loan book exposure is not diversified. Lack of diversification means the risk that an adverse event affecting one borrower or one type of loan will simultaneously affect the majority of borrowers, and therefore put the overall portfolio at risk is greater.

Risk feature	Description	What this means
Inconsistency in valuations	The valuations lenders rely on are carried out on a variety of bases, with differing assumptions and instructions.	This makes it difficult to assess reliably the risk exposure associated with a loan, and difficult to monitor loan-to-valuation ratios on a continuing basis.
Related party lending	Funds raised through debentures are often on-lent to companies or businesses associated with the debenture issuer.	There is an increased risk that lending decisions will not be made on arms' length commercial terms, and that the debenture issuer who makes the loans will not monitor performance by the borrower as rigorously as it would in an arms' length transaction.
Misleading advertising	Advertising used to promote some debentures helps create unrealistic expectations about the relative safety of the debentures.	Even if the prospectus disclosure highlights risk in an appropriate way, advertising that conveys messages not in line with the regulated disclosure document can undermine the effect of that disclosure.

Unlisted debentures

RG 69.29 Unlisted debentures pose particular challenges, because retail investors who hold these types of securities do not have the benefit of price discovery mechanisms and market forces to:

- (a) help them work out the value of their securities on an ongoing basis;
- (b) monitor and publicise the ongoing performance of the issuer (through a licensed market's continuous disclosure regime); and
- (c) provide them with a reliable way to exit their investment efficiently.

RG 69.30 Being unlisted means there is no liquid secondary market on which an investor can sell an investment that is no longer required, or in which the investor has lost confidence. Some debenture issuers offer early exit mechanisms, but these are likely to be unavailable if the issuer is in financial difficulty.

RG 69.31 Being unlisted also means that there is no market supervisor to:

- (a) initially assess and, if appropriate, admit the issuer's securities to trading; and
- (b) supervise the issuer's ongoing compliance with any listing rules, in particular, a continuous disclosure regime.

Lack of benchmarks

RG 69.32 Typically, there are few external benchmarks retail investors can use to assess and understand the risk of the investment, and the value of the debentures they may subscribe for. In particular:

- (a) retail investors cannot obtain and rely on research prepared by recognised credit rating agencies, market professionals (such as analysts) or the coverage the financial media provides for many listed securities;
- (b) historically, most of these debentures have not held a credit rating from a recognised credit rating agency;
- (c) few retail adviser groups conduct detailed research on individual debenture products; and
- (d) retail investors do not have a way of assessing the market value of their investment, and of monitoring the ongoing performance of the issuer, as reliably as they would have if these products were listed and traded on a regulated financial market (and therefore subject to the relevant supervision and continuous disclosure regime).

RG 69.33 Risks are most significant where funds are on-lent for the development of property assets. Reasons include that there is often no cash flow to meet obligations until after a development has been completed and can be sold. In these circumstances, there is likely to be greater uncertainty about whether properties can be completed and sold for anticipated values; and if further loan investments are needed to complete development projects, the overall viability of the venture may be doubtful because interest costs for the project will increase.

RG 69.34 Nonetheless, the features described in Table 4 are present, or potentially present, to varying extents in many forms of debenture investments. For example:

- (a) the underlying business models of property development issuers share some features with other debenture issuers who on-lend funds to third parties;
- (b) many types of debenture issuers have low levels of equity capital; and
- (c) many types of debenture issuers have some degree of mis-match between the maturities of their assets and liabilities, making them vulnerable to liquidity problems in adverse market conditions.

C Benchmarks for unlisted debentures

Key points

All issuers of unlisted debentures should address general benchmarks on:

- equity ratio (see RG 69.35);
- liquidity (see RG 69.38);
- rollovers (see RG 69.45);
- credit ratings (see RG 69.49);

Issuers of unlisted debentures who lend money should address additional benchmarks on:

- loan portfolio (see RG 69.58);
- related party transactions (see RG 69.68);

Issuers of unlisted debentures involving property should address additional benchmarks on:

- valuations (see RG 69.71); and
- lending principles—loan-to-valuation ratios (see RG 69.77).

Benchmark 1: Equity ratio

RG 69.35

All issuers should use the following equity ratio benchmarks:

- where more than a minor part of the issuer's activities is property development or lending funds directly or indirectly for property development—the issuer should maintain a minimum equity ratio of 20%;
- in all other cases—the issuer should maintain a minimum equity ratio of 8%; and
- the debenture issuer's equity ratio should be calculated as follows:

$$\frac{\text{total equity}}{\text{total liabilities} + \text{total equity}}$$

Note: 'Equity' and 'liabilities' have the meanings given under the Australian Accounting Standards.

Explanation

RG 69.36

Paid-up capital or equity is the money invested by the owners of the issuer (plus any profits retained by the issuer). It provides a 'buffer' to the issuer in the event of financial difficulties, and it also provides the issuer's owners with an incentive to operate prudently and responsibly (sometimes referred to as 'hurt money' or 'skin in the game'): see 'Minimal equity capital' in Table 4.

RG 69.37 Insufficient capitalisation appears to be a contributing factor in each of the failures of unlisted, unrated debenture issuers in recent years. Property development-related lenders are more vulnerable to adverse market movements and at higher risk of financial distress. So we propose a higher minimum capital where more than minor part (e.g. 10%) of the issuer's activities (e.g. as a proportion of debentures on issue) are property development-related. If this capital is not present, investors should be informed (on an 'if not, why not' basis) so they can make their own assessment of the risks involved.

Benchmark 2: Liquidity

RG 69.38 All issuers should:

- (a) have cash flow estimates for the next 3 months; and
- (b) ensure that at all times they have cash or cash equivalents sufficient to meet their projected cash needs over the next 3 months.

Note: In estimating cash flows an issuer can take into account a reasonable estimate of 'rollovers' based on previous experience, but not new fundraising. Issuers should consider possible redemptions as well (if their policy or practice is to allow redemptions). Issuers can also take into account reasonable estimations of cash inflows generated by operations (e.g. payments of interest, repayments of debt) in preparing their cash flow projection. 'Cash' and 'cash equivalents' have the same meanings as in Australian Accounting Standard AASB 107 *Cash flow statements*.

RG 69.39 Issuers should also disclose:

- (a) their policy on balancing the maturity of their assets and the maturity of their liabilities. For example, where an issuer has a policy of ensuring that their assets and liabilities have similar maturity profiles, they should state this in their prospectus and report against this in their ongoing disclosures; and
- (b) material assumptions underlying their cash flow estimates (e.g. historical rollover rate).

Explanation

RG 69.40 Liquidity is the proportion of cash or cash equivalents in a company's assets. It is a powerful indicator of the short-term financial health of a company. For debenture issuers it is relative liquidity (i.e. short-term assets relative to short-term liabilities) that we are particularly concerned with.

RG 69.41 Recent experience and expert advice ASIC has received show adequate liquidity is a key feature in the ability of debenture issuers to meet their obligations to investors. Insufficient liquid assets appear to be a contributing factor in recent failures. Historically, lack of liquid assets has been a contributing factor in the failure of otherwise well-capitalised institutions.

- RG 69.42 We envisage issuers would need to review their forecast cash flows on an ongoing basis to determine whether they continue to satisfy this benchmark. We would expect issuers to take into account their historical experience on redemptions and rollovers in estimating their cash flows. We also expect issuers to disclose material assumptions underlying their cash flows (e.g. historical rollover rate) when reporting against this benchmark.
- RG 69.43 By ‘cash or cash equivalents’ we mean cash or cash equivalents as defined in Australian Accounting Standard AASB 107 *Cash flow statements*. Generally this includes highly liquid assets that can be reliably realised for cash within a very short period of time and undrawn amounts under certain bank overdraft facilities.
- RG 69.44 We expect issuers to periodically ‘stress test’ their liquidity assumptions. For example, we would expect issuers to consider:
- (a) their current prospectus and the possibility of an ASIC stop order disrupting their cash flows;
 - (b) the possibility of an overdraft or other credit facility on which the issuer is relying being withdrawn; and
 - (c) the possibility of a significant reduction in the rate of investor rollovers.
- We would expect issuers to take into account the results of their stress testing in their liquidity planning. In some cases, this may mean they need to increase their cash position: see RG 69.38.

Benchmark 3: Rollovers

- RG 69.45 All issuers should clearly disclose their approach to rollovers, including whether the ‘default’ is that debenture investments with them are automatically rolled-over.

Explanation

- RG 69.46 Some debenture issuers rely on investors keeping their funds in the investment beyond the end of the initial period. In some cases, the terms of the issue allow this to occur automatically unless the investor makes a positive decision to withdraw their funds. In other cases, it is the investor who makes a positive decision to have their funds re-invested. It is important that investors fully understand the issuer’s approach to rollovers through clear disclosure in the prospectus.
- RG 69.47 Subsection 708(14) provides for an exception from the requirement to provide investors with a prospectus for rollovers and offers to existing investors. ASIC considers that it is potentially misleading not to provide investors with updated information when they are considering whether to rollover their investment or make a further investment in debentures.

RG 69.48 The commercial circumstances of the issuer may have changed since the initial investment. To ensure investors are fully informed about the circumstances of the rollover, it is important for them to have the benefit of current disclosure (in either a prospectus or disclosure notice) to help them decide whether to continue with their investment. As a matter of good practice, issuers should contact investors before each rollover and make the current disclosure document and any relevant ongoing disclosures available to them (e.g. direct them to a website where they can obtain the documents).

Benchmark 4: Credit ratings

RG 69.49 All issuers should:

- (a) have their debentures rated for credit risk (i.e. the risk that the principal and interest will not be repaid at the end of a relevant period);
- (b) use a recognised credit rating agency for this purpose;
- (c) state the current rating in their prospectus, who it is from and briefly explain the rating (i.e. what it says about the risk of the investor not getting their money back); and
- (d) take reasonable steps to ensure the rating remains current.

Note: See also Regulatory Guide 156 *Debenture advertising* (RG 156).

Explanation

RG 69.50 Recent experience suggests investors find it difficult to assess the credit risk involved in debentures and therefore to understand what is an appropriate rate of return to expect. They do not understand the risk of the principal not being repaid and hence cannot always assess whether the return being offered is adequate or that the risk is appropriately priced.

RG 69.51 Credit ratings carried out by a recognised ratings agency are a well-established and widely-used method of assessing and communicating the credit risk of an issuer and its debt securities. They do so by analysing a debenture against detailed criteria and assigning it a rating. For each rating category, the ratings agency expresses a view on the likelihood of issuers of debentures in that category experiencing an event of default, based on historical average default rates for similar products. This provides an external opinion about the debenture, which helps investors decide whether the product is suitable for them and whether it is appropriately priced. Some debenture issuers already obtain credit ratings for their debentures.

RG 69.52 ASIC has already recognised the following credit rating agencies for regulatory purposes, and we believe these are the appropriate ratings agencies for this benchmark:

- (a) Moody's Investors Service Pty Limited;

- (b) Standard & Poor's (Australia) Pty Limited; and
- (c) Fitch Australia Pty Limited.

RG 69.53 Under our existing relief, these recognised credit rating agencies are obliged to give certain warnings, comply with the Code of Conduct Fundamentals for Credit Rating Agencies (issued in December 2004 by the Technical Committee of the International Organisation of Securities Commissions) and provide information to ASIC on request: see Class Order [CO 05/1230] *Credit rating agencies*.

RG 69.54 Where an issuer has obtained more than one credit rating for their debentures, they should disclose each of them. We expect issuers to disclose if they have received a proposed or indicative rating that they have not proceeded with to become a final rating. Issuers should *not* use an 'investment rating' (regardless of who it is from) or a credit rating from a person other than a recognised credit rating for the purposes of this benchmark.

RG 69.55 Ratings can assist retail investors. But they are not widely understood by retail investors and do not supply a complete answer. Care is needed to ensure the investor understands the benefits and the limits of ratings and criteria used by the rating agency. They play an important role but need to be supplemented by the other disclosure benchmarks.

Note: For example, historically some of the failures experienced here and overseas have involved issuers and products that had a current credit rating.

Rated debentures

RG 69.56 Obtaining a credit rating will assist issuers in considering and assessing the extent to which they meet the other benchmarks. It will also help issuers communicate how they have met the benchmarks to investors, particularly because it gives an independent expert assessment of the debentures that take into account (among other things) the issues raised in the benchmarks. It will also give us greater confidence that the issuer's disclosures against the benchmarks are robust and reliable.

RG 69.57 If an issuer of a previously unrated debenture obtains a rating for that debenture in response to this benchmark, we expect them to disclose it in their prospectus and advertising (see RG 69.49 and CP 94). We expect that issuers who obtain a rating for their debentures will be able to more easily reassure investors that they have met the other benchmarks.

Benchmark 5: Loan portfolio

- RG 69.58 Issuers who directly on-lend funds or indirectly on-lend funds through a related party should disclose the current nature of their (or the related party's) loan portfolio, including:
- (a) how many loans they have and the value of those loans;
 - (b) by number and value, loans they have by class of activity and geographic region;
 - (c) by number and value, what proportion of loans are in default or arrears;
- Note: An issuer should disclose, by number and value, what proportion of loans are in both default and arrears if these terms have different meanings in the issuer's lending policy.
- (d) by number and value, what proportion of the total loan money is lent on a 'secured' basis and what is the nature of the security; and
 - (e) by number and value, what proportion of the total loan money they have lent to their largest borrower and 10 largest borrowers.

Note 1: We acknowledge that, for reasons of privacy or commercial confidence, it may not be appropriate to actually *name* the largest borrowers. The total loan money lent to the 10 largest borrowers can be disclosed as an aggregated amount.

Note 2: The term 'related party' should be interpreted broadly: see Key terms.

- RG 69.59 Disclosure should also cover their policy on these issues. For example, where the issuer has a policy of not lending more than (say) 5% of their total loan funds to any one borrower, this should be stated in the disclosure document.
- RG 69.60 Disclosure should also contain clear explanations about the issuer's approach to taking security in relation to its lending (e.g. what types of security it takes and in what circumstances).

Explanation

- RG 69.61 This and the following benchmark (related party transactions) applies to debenture issuers who on-lend funds raised through the debentures. This includes issuers who lend the funds to related parties only.
- RG 69.62 Many issuers of unlisted debentures on-lend the funds lent to them by debenture holders. The primary assets of the issuer are the loans they make to others. The quality of these loans is a key element in the financial position and performance of the issuer.
- RG 69.63 The quality of the issuer's loans is important at an overall loan portfolio level, as well as the individual loan level. A key way lenders manage the quality of an overall loan portfolio is to ensure that it is diversified. Portfolio diversity has a number of elements, including:
- (a) the number of loans and the value of those loans;

- (b) how many loans are related to a particular class of activity (e.g. residential property, commercial property, leasing, development);
- (c) geographic concentration (e.g. are the borrowers concentrated in one geographic region?); and
- (d) whether the lender has major exposures to a small number of borrowers (e.g. what proportion of funds are lent to the largest borrower, and to the 10 largest borrowers?).

RG 69.64 The more diversified a loan portfolio is, the lower the risk that an adverse event affecting one borrower or one type of loan will simultaneously affect the majority of borrowers, and therefore put the overall portfolio at risk.

RG 69.65 It is important that issuers disclose in their prospectus their approach to loan portfolio diversification. At the prospectus stage, an issuer may not be able to set out exactly how funds will be lent, but they should be able to generally explain how funds have been lent so far. Most issuers will have a firm policy of how and when they will lend funds. This should be disclosed as clearly and concretely as possible to help trustees and investors monitor the financial position and performance of the issuer over time.

RG 69.66 It is important that investors understand what proportion of loans are secured, by number and by value. However, this needs to be explained carefully, including by reference to the nature and scale of the security (e.g. its ranking, the value of the assets supporting the security and the financial position of any guarantor).

Note: If any security rights (e.g. mortgages) held by the issuer have been assigned or transferred to third parties, this needs to be disclosed as well.

RG 69.67 It is also important for investors to know what proportion of loans are in default and what the issuer's approach is to such loans. Because the issuer is relying heavily on repayment of the loans it has made for it to repay debenture monies, the investors (as the holders of the debentures) have a strong interest in the proportion of loans in arrears and what the issuer is doing to address this.

Benchmark 6: Related party transactions

RG 69.68 Issuers who on-lend funds should disclose their approach to related party transactions, including:

- (a) how many loans they have made to related parties and the value of those loans; and
- (b) what assessment and approval process they follow with related party loans (e.g. are they subject to approval of the trustee?).

The issuer should also disclose any policy it has regarding related party lending.

Note: The term 'related party' should be interpreted broadly: see Key terms.

Explanation

- RG 69.69 Related party loans are less likely to be monitored as robustly as third-party loans, and this can affect valuations, loan-to-valuation ratios and credit assessment processes. Related party loans appear to be a contributing factor in some recent failures.
- RG 69.70 It is important that issuers disclose in their prospectus their approach to related party lending. At the prospectus stage, an issuer may not be able to set out exactly how funds will be lent, but they should be able to generally explain how funds have been lent so far. As discussed under the previous benchmark, we expect that most issuers will have a firm policy of how and when they will lend funds and this should be disclosed to investors.

Benchmark 7: Valuations

- RG 69.71 Where the issuer is involved in or (directly or indirectly) lends money for property-related activities, they should take the following approach to valuations:
- (a) properties (i.e. real estate) should be valued on an ‘as is’ and (for development property) ‘as if complete’ basis;

Note: See Key terms for definition of ‘as is’ and ‘as if complete’ valuations.
 - (b) issuers should have a clear policy on how often they obtain valuations, including how recent a valuation has to be when they make a new loan;
 - (c) issuers should establish a panel of valuers and ensure that no one valuer conducts more than 1/3 of the total number of valuations they obtained; and
 - (d) appointment of valuers should be with the trustee’s consent.
- RG 69.72 Issuers should also include information about the valuation of a particular property in the issuer’s prospectus where:
- (a) the property accounts for 5% or more of the total value of property assets of the issuer;
 - (b) the property accounts for 5% or more of the total value of property assets of a related party through which the issuer has indirectly on-lent money: see RG 69.58;
 - (c) a loan secured against the property accounts for 5% or more of the total value of issuer’s loan book; or
 - (d) a loan secured against the property accounts for 5% or more of the total value of the loan book of a related party through which the issuer has indirectly on-lent money: see RG 69.58.
- Note 1: We would also expect issuers to include the ‘cost’ of such a property in the prospectus for comparison purposes.

Note 2: The information about the valuation of a particular property should help the potential investor assess the quality and reliability of the valuation (e.g. the identity of the valuer, the valuation method and key assumptions).

Explanation

RG 69.73 This benchmark *only* applies to debenture issuers who are (directly or indirectly) involved in or on-lend funds for property-related activities. It includes issuers who, for example:

- (a) are in the business of property development or lend funds to property developers;
- (b) use funds as part of an ‘integrated property’ business; or
- (c) are involved in mortgage financing.

Note: ‘Integrated property’ is defined in CP 89. See also RG 69.25.

RG 69.74 Robust and objective valuations are needed to ensure the issuer’s financial position is correctly stated in the prospectus and ongoing disclosures. Valuations affect the key ratios of the issuer—such as the adequate capital, liquidity and loan-to-valuation policies.

RG 69.75 It is therefore important for investor confidence that independent experts perform the valuations, and that the process is transparent.

Note: See Section F for further discussion of valuers and the valuation process.

RG 69.76 It is in the interests of issuers that the valuations they obtain and use are robust and accurate. Issuers are responsible for the accuracy of the financial statements and other documents that rely on these valuations. Therefore, we expect that issuers will only use professional valuers who are registered or licensed in the relevant state or territory, and who subscribe to a relevant industry code of conduct. We also expect that issuers will be careful to ensure that their instructions to valuers are comprehensive and contain reasonable assumptions.

Benchmark 8: Lending principles—loan-to-valuation ratios

RG 69.77 Where an issuer (directly or indirectly) on-lends money in relation to property-related activities, it should maintain the following loan-to-valuation ratios:

- (a) where the loan relates to property development—70% on the basis of the latest ‘as if complete’ valuation; and
- (b) in all other cases—80% on the basis of the latest market valuation.

Note: The loan-to-valuation ratio should be based on the unencumbered value of the property (i.e. less the value of any existing secured loans against the property).

RG 69.78 Where the loan relates to property development by a second person (even if related to the issuer), issuers should ensure that funds raised by the issue of

debentures are only provided to the developer in stages, based on external evidence of the progress of the development.

Explanation

- RG 69.79 This benchmark *only* applies to debenture issuers who (directly or indirectly) on-lend funds for property-related activities. It includes issuers who, for example:
- (a) lend funds to property developers; or
 - (b) are involved in mortgage financing.
- RG 69.80 An issuer's approach to loan-to-valuation ratios is one indicator of how conservative or aggressive its lending practices are. Less conservative lenders are willing to lend funds equal to a higher proportion of a property's value (sometimes up to or exceeding 100% of its value). Such ratios mean that the lender is more vulnerable to the risk that a change in market conditions (such as downturn in the property market) means it is unable to fully recover the money it has lent to borrowers. It also increases the risk that the security (if any) it has obtained from borrowers will not be sufficient to cover the loan.
- RG 69.81 We have separated loans relating to property development from other property-related loans (e.g. residential mortgages). By property development, we mean loans whose main or primary purpose is for real estate developments (e.g. home units, retail, commercial, sub-divisions and industrial development).
- RG 69.82 Where funds are on-lent for property development activities a loan-to-valuation ratio may be agreed up-front, but it is generally not appropriate to advance all of the funds to the developer up-front. Rather, we expect issuers to put systems and controls in place to ensure funds are only provided to the developer where there is satisfactory progress of the development (based on reliable external evidence of that progress). We also expect that the issuer's policy on how and when funds are provided to developers will be stated in their prospectus.

D Disclosure against the benchmarks—‘If not, why not’

Key points

Issuers should use the benchmarks in Section C on an ‘If not, why not’ basis in meeting their disclosure obligations to investors: see RG 69.83–RG 69.85.

Disclosure against the benchmarks should be:

- addressed upfront in the prospectus (see RG 69.86–RG 69.94);
- updated in ongoing disclosures as material changes occur, for example:
 - in a replacement prospectus, supplementary prospectus or continuous disclosure notice (see RG 69.95); and
 - at least twice a year, in quarterly reports to trustees (see RG 69.96); and
- supported in advertising material (see CP 94).

‘If not, why not’ approach

RG 69.83 Issuers should disclose whether they meet the benchmarks in Section C, and if not, why not. ‘Why not’ means explaining how an issuer deals with the business factor or issue underlying the benchmark (including the alternative systems and controls the issuer has in place to deal with the issue underlying the benchmark).

Note: Where a benchmark contains multiple requirements, if an issuer cannot meet all requirements under a benchmark, they should state that they do not meet the benchmark and clearly explain why they failed to meet particular requirements.

RG 69.84 Disclosure against the benchmarks is not intended to lead to longer and more complex disclosure documents. Rather, we expect that these disclosure proposals will help issuers produce disclosure documents that are more focused on the issues that matter to investors and are more clear, concise and effective.

RG 69.85 This approach is based on our view that the inherent risks for investors in unlisted debentures mean that information about these risks is:

- (a) information that investors and their professional advisers reasonably require to make an informed investment decision (s710(1));
- (b) not something investors may reasonably be expected to know without explicit disclosure in a prospectus (s710(2));
- (c) needed to ensure a debenture issuer’s quarterly reports to the trustee and to ASIC comply with the content requirements for those reports (s283BF(4)); and

- (d) relevant to consideration of whether the issuer is required to issue a supplementary or replacement prospectus (s719) or has obligations under the continuous disclosure provisions (s675).

Note: ASIC has produced an investor guide, *Investing in debentures?* to help investors understand and use the new disclosure benchmarks and promote informed decision-making. We encourage issuers to make the guide available to investors, for example when distributing their prospectus. Copies of the investor guide are available at www.fido.gov.au. Issuers can order paper copies by writing to debentures@asic.gov.au.

Upfront disclosure in a prospectus

- RG 69.86 A prospectus for unlisted debentures should address the benchmarks in Section C on an ‘if not, why not’ basis. This means that it should state that the issuer and product either:
- (a) meet the benchmark (including how they meet the benchmark, where appropriate); or
 - (b) do not meet the benchmark *and* explain how and why the issuer deals with the business factor or issue underlying the benchmark in another way.
- RG 69.87 A prospectus for debentures should contain a clear and prominent disclosure of the key features of the product and its risks. This key features and risks disclosure should be in the first few pages of the prospectus.
- RG 69.88 We expect an issuer’s prospectus to explain in a clear, concise and effective way:
- (a) the business model of the issuer and what they will actually do with the money;
 - (b) the track record and experience of senior management; and
 - (c) what the nature of the debenture is (e.g. what (if any) security exists and whether the issuer is prudentially regulated).

In particular, we expect issuers to make it completely clear that the debentures are not and should not be confused with bank deposit products.

The role of upfront disclosure

- RG 69.89 The law requires upfront disclosure for these products through the mechanism of a prospectus. If you are an issuer preparing a prospectus, you must:
- (a) include all information that investors and their professional advisers would reasonably require to make an informed assessment of the issuer and the securities being offered (s710);
 - (b) make specific disclosures (s711); and
 - (c) word and present the prospectus in a clear, concise and effective manner (s715A).

- RG 69.90 The general prospectus content requirement in s710 is designed to:
- (a) promote efficiency in the capital markets;
 - (b) promote disclosure of relevant information;
 - (c) reduce the likelihood of omitting important information;
 - (d) focus issuers on the information needs of investors; and
 - (e) be sufficiently flexible to accommodate changes in investors' information needs.

In particular, a prospectus should allow the investor to assess the financial position, performance and prospects of the issuer.

- RG 69.91 Our benchmarks relate to matters that in any event must be disclosed under s710. Issues relating to the amount of capital, liquidity, loan ratios, valuations, related party loans and diversification are all matters that investors and their professional advisers would reasonably require to make an informed assessment of the assets and liabilities, financial position and performance, profits and losses and prospects of the issuer.

- RG 69.92 We expect an issuer to comply with these benchmarks or explain why they do not. In addition, we consider that s710 requires:
- (a) disclosure of these benchmarks and how they have been complied with;
 - (b) a statement that the issuer will comply with these benchmarks going forward and if not, why not; and
 - (c) in circumstances where there is non-compliance with these benchmarks, disclosure of the extent of non-compliance and the reason for non-compliance. In some circumstances non-compliance with these benchmarks is a risk that should be disclosed prominently.

We also expect any audit qualification applying to an issuer's financial report to be disclosed and explained in a prospectus.

Note: A prospectus for debentures should address the benchmarks in Section C prominently and in one place (e.g. in the first few pages of the prospectus either by a separate section or a clear and well-referenced summary table).

- RG 69.93 We will consider exercising our stop order powers under s739 if we consider there is material non-disclosure of these matters. We believe that disclosure of compliance with these benchmarks up-front in a prospectus promotes compliance with the requirement that prospectuses should be worded in clear, concise and effective manner by encouraging comparability and uniformity of financial measures and highlighting issues which ASIC and industry experts consider crucial to making an investment decision.

- RG 69.94 Experience suggests that clear, concise and effective prospectus disclosure requires simple and clear disclosure of the business model of the issuer and the key risks associated with the issue. We encourage issuers to use

consumer-friendly tools as much as possible in disclosing key features and risks, including by using tables, diagrams and other comparative features.

Ongoing disclosures

- RG 69.95 Where there have been any material changes to an issuer's performance against the benchmarks, including against the issuer's alternative approach to meeting the benchmarks, the issuer should explain this in:
- (a) a supplementary prospectus;
 - (b) a replacement prospectus; or
 - (c) a continuous disclosure notice.
- RG 69.96 In addition, an issuer's quarterly reports should, at least twice a year, *specifically* explain any material changes to the issuer's performance against the benchmarks set out in Section C, including against the issuer's alternative approach to meeting the benchmarks.

The role of ongoing disclosures

- RG 69.97 Good ongoing disclosure plays an important role in helping investors monitor their investment, evaluate its performance and decide if and when to exit the product. Issuers make a number of statements in the prospectus about how the funds being raised will be used, and how the issuer will conduct their business. These 'promises' are part of the basis on which the investor invests their money, and the investor should be given the opportunity to monitor the issuer's performance against these promises.
- RG 69.98 Issuers have a number of ongoing disclosure obligations that help investors and the trustee monitor performance. These include:
- (a) issuing a supplementary or replacement prospectus (as needed);
 - (b) quarterly reports to the trustee, which are also lodged with ASIC (s283BF(4));
 - (c) audited annual and half-yearly financial reports (Chapter 2M); and
 - (d) continuous disclosure of material information not otherwise covered by a new prospectus or supplementary prospectus (s675).

Supplementary or replacement prospectus

- RG 69.99 Where there is a current prospectus, s719 requires an issuer to lodge a supplementary or replacement prospectus where, among other matters, there is misleading or deceptive statement in the prospectus or where there is an omission of information required under s710.
- RG 69.100 In cases where there is no current prospectus, if the issuer becomes aware of information that is not generally available and a reasonable person would expect, if it were available, to have a material effect on the price or value of

the securities of the entity, s675 requires the issuer to lodge a document with ASIC containing the information. Where there is a prospectus on issue, s675 does not require lodgement of a document with ASIC if the information is included in a supplementary or replacement prospectus.

RG 69.101 Supplementary and replacement prospectuses must be given to prospective investors: s719(4) and (5), 704. Debenture holders can ask for the financial reports of an issuer free of charge: s318.

Quarterly reports

RG 69.102 Quarterly reports must include details of:

- (a) money deposited with or lent to a related body corporate (s283BF(5)) including:
 - (i) the total of the money deposited with or lent to the related body corporate; and
 - (ii) the total amount of money owing to the borrower at the end of the quarter in respect of the deposits or loans to the related body corporate;
- (b) details of any liability of a related body corporate that the borrower has assumed during the quarter including the extent of the liability at the end of the quarter (s283BF(6));
- (c) any failure of the borrower to comply with the terms of the debentures;
- (d) any circumstances that have occurred during the quarter that materially prejudice the issuer;
- (e) any substantial change in the nature of the business of the borrower that has occurred during the quarter; and
- (f) any other matters that may materially prejudice any security or the interests of the debenture holders: s283BF(4).

RG 69.103 Quarterly reports are designed to give the trustee (and ASIC) regular updates about the performance of the issuer. The benchmarks in Section C are the key features and risks for these products, so in our view diversions from the benchmarks are material issues that should be covered in quarterly reports. For example, if the issuer stopped meeting the minimum capital or liquidity benchmark during the quarter, this would clearly be a matter that materially prejudices the interests of the debenture holders and that should be brought to the trustee's attention.

Making ongoing disclosures available

RG 69.104 Ongoing disclosure documents (including those lodged with ASIC) should be made available to all debenture holders (e.g. by issuers putting them on their website). ASIC will also make ongoing disclosure documents generally available where they are lodged with us so that investors can:

- (a) monitor their investments in these products; and
- (b) know what information is available to trustees in their monitoring role.

We believe this will encourage greater scrutiny of the ongoing operations of the issuer, and help trustees and investors in monitoring the financial position and performance of the issuer.

When you need to disclose against the benchmarks

- RG 69.105 Our approach to additional and improved disclosure applies to both existing and new offers of debentures. We do not expect existing offer documents to be rewritten, but it is important that issuers with current offers open also provide this new information to investors in a timely way.
- RG 69.106 Table 5 sets out when we expect new and existing issuers to adopt this ‘if not, why not’ approach against the benchmarks in their disclosures and advertising.
- RG 69.107 We will review updated investor disclosures and quarterly reports for each issuer in this industry sector in the period to June 2008 to check that this benchmarking information is adequately disclosed to investors on an ‘if not, why not’ basis: see RG 69.13.

Table 5: Implementing the ‘if not, why not’ approach against the benchmarks

	New issuers	Existing issuers
Upfront disclosure	All prospectuses issued on or after 1 December 2007 should follow our ‘if not, why not’ approach to disclosing against the benchmarks.	All new prospectuses issued on or after 1 March 2008 should follow the ‘if not, why not’ approach to disclosing against the benchmarks.
Ongoing disclosures (including quarterly reports)	<p>Ongoing disclosures made on or after 1 December 2007 should specifically refer to your performance against the disclosure benchmarks (or where you take an alternative approach on one or more benchmarks, against these alternative approaches).</p> <p>From 1 December 2007, your quarterly reports to the trustee should set out your performance against the benchmarks at least twice a year.</p>	<p>By 1 March 2008, you should issue (and lodge with ASIC) an ongoing disclosure document specifically referring to your performance against the disclosure benchmarks (or where you take an alternative approach on one or more benchmarks, against these alternative approaches).</p> <p>Ongoing disclosures made on or after 1 March 2008 should specifically refer to your performance against the disclosure benchmarks (or where you take an alternative approach on one or more benchmarks, against these alternative approaches).</p> <p>From 1 March 2008, your quarterly reports to the trustee should set out your performance against the benchmarks at least twice a year.</p>

Note: See also CP 94.

Existing issuers

- RG 69.108 For existing issuers, the first information investors will see about the benchmarks and the issuer's performance against them will be after they have made their investment decision. Therefore, by 1 March 2008, we expect existing issuers to specifically address each of the benchmarks in Section C on an 'if not, why not' basis in a:
- (a) supplementary prospectus;
 - (b) replacement prospectus; or
 - (c) continuous disclosure notice.
- RG 69.109 It is important that issuers bring this information directly to the attention of investors. We expect issuers to bring their first ongoing disclosure document that specifically refers to the issuer's performance against the benchmarks to the attention of their existing debenture holders. This could be done by:
- (a) sending the report to their existing investors; or
 - (b) publishing the report on their website and notifying investors that it is available and how to access it.

E Trustees

Key points

We expect trustees of issues of unlisted debentures to support the guiding principles in Table 1.

In particular, we expect trustees to actively monitor the financial position and performance of the issuer.

The trustee's role

- RG 69.110 The law requires that when debentures are offered and a prospectus is required, the issuer must also appoint a trustee. The trustee's duty under the trust deed and the Corporations Act is to 'exercise reasonable diligence' in monitoring the issuer's ability to repay the debentures (e.g. its financial position and performance). In some circumstances, they may need to notify ASIC, seek appropriate court orders or call a meeting of investors to fulfil their duties.
- RG 69.111 Issuers should set out in their prospectuses whether they meet the benchmarks in Section C and if not, what alternative approach they take to managing the issues underlying those benchmarks. In our view, the matters referred to in these benchmarks are key to an issuer's ability to meet its obligations to investors, and particularly its obligations to repay principal sums invested by debenture holders at the time set out in the terms of the debenture.
- RG 69.112 In that sense, what issuers say in their prospectuses about the benchmarks are relevant to a trustee's obligation to monitor whether the issuer will be in a position to repay amounts lent by debenture holders.
- RG 69.113 We therefore consider that trustees should consider an issuer's performance against the benchmarks in fulfilling their obligations under the legislation.

Monitoring against the benchmarks

- RG 69.114 If an issuer discloses in a prospectus that they meet each of the benchmarks, continuing performance against them is directly relevant to the issuer's ongoing ability to meet its repayment obligations. If an issuer ceases to meet a benchmark, in our view a reasonably diligent trustee should carry out sufficient inquiries to satisfy itself that the ability of the issuer to meet its obligations has not been materially impaired.

- RG 69.115 Similarly, if an issuer’s prospectus discloses that an issuer does not meet one or more benchmarks, a trustee should use the ‘why not’ part of that disclosure to understand enough about the way the issuer is operating its business, to use that understanding to monitor the issuer’s ongoing ability to meet its obligations to investors.
- RG 69.116 Issuers should also be reporting against the benchmarks in their ongoing disclosures. This is one of the reasons why, at least twice a year, issuers should include in their quarterly report to the trustee information about their performance against the benchmarks as discussed in their prospectus: see RG 69.102. We expect trustees to scrutinise these reports and to use them to monitor the financial performance of the issuer because it is critical to the issuer’s ability to repay the debenture holders.
- RG 69.117 We expect trustees to:
- (a) actively monitor the financial position and performance of the issuer, including using the benchmark and other information set out in the quarterly reports, and half-year and annual financial reports; and
 - (b) assess and form a view (and record this in writing) about the financial position and performance of the issuer at regular intervals (e.g. at least quarterly).
- RG 69.118 We do not expect trustees to form a view about whether the issuer’s disclosure documents comply with the law, but we do expect trustees to use the information in those disclosures to monitor the financial position and performance of the issuer.
- RG 69.119 If a trustee forms the view that an issuer is failing to meet the promises made in their disclosure documents or that there have been material adverse changes in the financial position or performance of the issuer, the trustee should notify both ASIC and the investors promptly. For serious matters, we would expect the trustee to seek appropriate court orders or call a meeting of investors and seek their instructions about what action to take.

Underlying principles

- RG 69.120 The law requires a trustee to be appointed to help protect the interests of investors and to facilitate ongoing monitoring of the issuer. Issuers are obliged to report regularly to the trustee, including:
- (a) quarterly reports (s283BF);
 - (b) information about charges (s283BE); and
 - (c) half-yearly and annual financial reports (Chapter 2M).
- RG 69.121 The trustee has the power to call meetings of the investors and provide information to and make recommendations to the investors: s283EB. This is an important protective measure because the trustee has greater resources

and experience than retail investors, and is therefore more likely to identify issues with the financial position and performance of the issuer.

- RG 69.122 The trustee's statutory duty is to exercise reasonable diligence to ascertain:
- (a) whether the property of the issuer will be sufficient to repay the amounts lent; and
 - (b) whether the issuer has committed a breach of the 'terms of the debentures', the trust deed or Chapter 2L of the Corporations Act. This includes the issuer's general obligations to carry on their business in a 'proper and efficient manner': see s283DA.
- RG 69.123 In our view, monitoring the financial position and performance of the issuer generally, and the issuer's performance against the matters disclosed against the benchmarks in their prospectus, is part of exercising this reasonable diligence.
- RG 69.124 A trustee's duties are a combination of general law duties and duties set out the Corporations Act. We expect trustees to take their duties into account when negotiating the terms of trust deeds with issuers. To ensure that they are in a position to carry out their duties under the Corporations Act, trustees may need to negotiate additional terms or powers (e.g. the power to appoint an independent expert or the inclusion of some of the matters referred to in the benchmarks into their trust deed).
- RG 69.125 We consider that a lack of power for a trustee to intervene because of defects in the trust deed is an unacceptable reason for a trustee's failure properly to carry out its obligations under the Corporations Act. If a person is asked to take on a trustee role in circumstances where the proposed trust deed does not provide them with sufficient powers to ascertain whether an issuer will be able to meet its obligations to investors, the trustee may need to decline to act as trustee for that issuer.

F Auditors and valuers

Key points

We expect other parties involved with issues of unlisted, unrated debentures (in particular, auditors and valuers) to support the guiding principles in Table 1.

Auditors

- RG 69.126 Issuers must lodge half-yearly and annual financial reports. Annual reports must be audited, and half-yearly reports must at least be reviewed by an auditor. These reports help trustees and investors monitor the financial position and performance of the issuer.
- RG 69.127 When auditing the annual financial report of the issuer, we expect issuers to engage their auditors to prepare a separate report in relation to the benchmarks.
- RG 69.128 The auditor's report in relation to the benchmarks should have regard to information available in:
- (a) the quarterly report most recently submitted by the issuer to the trustee;
 - (b) recent continuous disclosure notices lodged during the financial year;
 - (c) the most recent prospectus; and
 - (d) any supplementary prospectus.

The auditor's report should be produced at the same time as the financial report and attached to the financial report lodged with ASIC. Copies of the auditor's report should be provided to any users of the financial report.

Note 1: ASIC has made a pro forma 'auditor's benchmark report' available that can be used to meet this requirement: see Pro Forma 223.

Note 2: For financial years and half-years ending on or before 31 December 2008 issuers need not provide the auditor's report on benchmarks to all users of the financial report, provided that the auditor's report is produced at the same time as the financial report and is submitted to ASIC and the trustee.

- RG 69.129 Auditors of debenture issuers have some additional obligations, designed to focus their attention on matters that the auditor becomes aware of during the audit. They are obliged to notify the trustee within 7 days of any matter that in the auditor's opinion 'is or is likely to be prejudicial to the interests of debenture holders': s313.

Valuers

- RG 69.130 A key aspect of the quality of the issuer's loan assets is their valuation. We expect valuers who accept an appointment to provide valuations for a debenture issuer to:
- (a) where possible, be registered under one of the state/territory valuer registration regimes; and
 - (b) include a warranty in their valuation reports that the report complies with all relevant industry standards and codes.
- RG 69.131 Robust and objective valuations are necessary to ensure that the issuer's financial position is correctly stated in the prospectus and ongoing disclosures. It is important that valuers involved with debenture issuers are regulated under the relevant state/territory regime and that these valuations comply with the relevant industry codes. However, we realise that not all states and territories have a registration or licensing regime at this time.

Key terms

Term	Meaning in this document
Australian Accounting Standards	Standards made for the purposes of s296(1) of the Corporations Act.
ASIC	The Australian Securities and Investments Commission
ASIC Act	The <i>Australian Securities and Investments Commission Act 2001</i> (Cth)
'as if complete' valuation	An estimate of the market value of a property, assuming certain specified improvements are made
'as is' valuation	An estimate of the market value of a property in its current state (i.e. without any further improvements)
Corporations Act	The <i>Corporations Act 2001</i> (Cth)
CP 94	An ASIC consultation paper (in this example, numbered 94)
market value	An estimate of the amount for which the property or asset could exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction
related party	The term 'related party' should be interpreted broadly, taking into consideration the definitions of 'related party' in s228 and accounting standard AASB 124 <i>Related party Transactions</i> .
rollovers	where an existing investor keeps their money in the existing debenture investment for an additional term (whether on the same or slightly different terms)
s710 (for example)	A section of the Corporations Act (in this example, numbered 710)

Related information

Headnotes

Debentures, listed, rated, advertising, issuers, trustees, auditors, valuers

Regulatory guides

RG 99 *Disclosure documents and PDS: quotation of securities and financial products*

RG 156 *Debenture advertising*

Legislation

Ch 2L, 2M, 6D *Corporations Act 2001*

Consultation papers

CP 89 *Unlisted, unrated debentures—improving disclosure for retail investors*

CP 94 *Debenture advertising*

Reports

REP 38 *High-yield debentures*

REP 108 *Report on submissions for CP 89 Unlisted, unrated debentures*

REP 113 *Report on submissions for CP 94 Debenture advertising*

REP 127 *Debentures—improving disclosure for retail investors*

Investor guides

Investing in debentures? Independent guide for investors reading a prospectus for unlisted debentures

Note: Issuers can order paper copies by writing to debentures@asic.gov.au

Class orders and pro formas

CO 05/1230 *Credit rating agencies*

PF 223 *Interim auditor's benchmark report*

Media and information releases

08-82 *ASIC acts to provide retail investors with better disclosure in unlisted unrated debentures*