



**Abacus**  
Australian Mutuals

Association of Building Societies and Credit Unions

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Rhys Bollen  
Regulatory Policy  
ASIC  
GPO Box 9827  
By email: [policy.submission@asic.gov.au](mailto:policy.submission@asic.gov.au)

Dear Mr Bollen

**Re: Consultation Paper 89: Unlisted, Unrated Debentures**

Thank you for the opportunity to contribute to ASIC's review of disclosure and consumer protection for unlisted, unrated debentures canvassed in *Consultation Paper 89*.

Abacus is the industry association for Australian credit unions and mutual building societies. Abacus draws together the activities of the former Credit Union Industry Association (part of Cuscal Ltd), National Credit Union Association and Australian Association of Permanent Building Societies. For more detail on Abacus see [www.abacus.org.au](http://www.abacus.org.au).

Credit unions and mutual building societies provide financial services to 4.5 million Australians and are:

- Authorised Deposit-taking Institutions (ADIs) subject to the *Banking Act 1959* and APRA regulation as ADIs;
- Australian Financial Services Licensees subject to the *Corporations Act 2001* and ASIC financial services regulation;
- lenders regulated under the *Uniform Consumer Credit Code*;
- subscribers to the *Electronic Funds Transfer Code of Conduct*; and
- reporting entities under the *Anti-Money Laundering and Counter-Terrorism Financing Act*.

As member-owned ADIs, credit unions and mutual building societies aim to provide quality personal service and to protect and promote the interests of their members. Abacus supports steps to improve the disclosure and market conduct of debenture investment products. We welcome ASIC's proposals and recommends further measures below.

Abacus has serious concerns about the marketing and general understanding of risk in the unlisted, unrated debenture market. Our industry has previously raised concerns about promotion that has borne a striking resemblance to ADI term deposits, using terms like "secured" and "guaranteed" to create false impressions about the security of funds invested.

We believe that some providers have sought to mislead unsophisticated investors with the impression that property-financing debentures have a low risk profile – implying a false equivalence to ADI deposits. Existing disclosure requirements are inadequate in these instances, especially where products are mass-marketed and target retirees or those near retirement. ASIC's proposals, while positive, will not address the range of issues in this market and Abacus recommends additional measures to support the benchmarks.

Credit unions and mutual building societies recommend additional steps of very direct product disclosure "warnings" and advertising limitations to improve the risk understanding of unsophisticated investors and ensure more accurate promotion of debenture investments.

## **1. Retail / Unsophisticated Investors: Abacus calls for stronger, blunt warnings**

ASIC's proposed approach involves expanded disclosure against a number of financial benchmarks, limitations on advertising (including measures to attempt to limit the scope for debenture products to appear as "like" ADI deposits) and new reporting obligations.

While the benchmarks proposed raise individual issues (see below), the proposals will assist active, sophisticated investors to better assess the risks and performance of debenture investments. Their effectiveness for less-sophisticated retail investors, however, will be limited and Abacus encourages ASIC to consider additional strategies.

Abacus agrees that existing disclosure has not assisted retail investors in accurately assessing risk. Anecdotal reports from credit unions suggest that some mutual ADI members have mistaken debentures for the equivalent of ADI term deposits, expecting a similar robust prudential framework to apply to their investment. Prospectus disclosure does not appear to have assisted retail investors in understanding risk, and ironically the fact that the prospectus is lodged with ASIC has (in our view) the danger of promoting a false impression of regulatory oversight of the investment company and products.

We believe the mass-market pitch and advertising of these investments is a key problem and encourage ASIC to consider measures to target this area of consumer decision making and understanding. Given the issues raised in recent high-profile collapses and the profile of investors who have lost their funds, Abacus has serious doubts about whether integrated and complex property financing debentures should be promoted as mainstream investment options for retail investors (regardless of additional financial disclosure requirements).

We are concerned that the proposed benchmarks will not provide a significant improvement in investor understanding for unsophisticated investors. It is unlikely that an average person without financial training would understand the difference between capital or liquidity and most would find it challenging to comprehend the significance of minimum equity requirements in this market. Easily referenced but complex benchmarks such as credit ratings also risk becoming de facto signs of "quality" for retail investors, without improving understanding of the risk underlying the investment.

It is important also that benchmarks do not contribute to poor outcomes, where high-risk debenture issuers might claim a "defence" for speculative activity because all investors should have an improved understanding the nature of the project and risks involved.

Credit unions and mutual building societies encourage ASIC to consider the addition of blunt, targeted and clear messages to assist retail investors in assessing the risk of this market segment as part of the proposed new disclosure approach.

Abacus suggests the addition to the disclosure regime of:

- a clear explanation in all advertising that the product is *not* a deposit product, specifically noting that it is not prudentially regulated, and not the equivalent of a deposit held with an APRA-approved ADI (ie a bank, building society or credit union);
- a notice wherever ASIC is mentioned (eg prospectus lodged with ASIC) to better clarify that the regulator does not review nor endorse debenture investments – including a message about risk, such as... "*ASIC views unlisted debentures as a high risk investment and encourages retail investors to carefully review risk and alternatives*";
- a warning box in product disclosure information highlighting that investors must be alert to the risk of losing their funds and not achieving projected returns.

Given the mass-market promotion of these debenture products Abacus considers this tier of general consumer warning critical to improving investor understanding of risks in debenture products. It should be prominent, upfront and included in advertising requirements.

We believe this form of disclosure will be critical in supporting ASIC's investor education messages for retail investors (including understanding risk and promoting diversification).

## **2. Proposed Benchmark Requirements**

ASIC's proposed reporting requirements and the "if not, why not" disclosure proposals are substantial and, in principle, supported. However, we believe that this type of disclosure is likely to be of most benefit to more sophisticated investors, and encourage ASIC to consider additional messages to promote risk awareness for unsophisticated retail investors. Abacus appreciates that there are complex considerations in each of the benchmarks proposed. We offer the following comments from the mutual ADI sector for consideration.

### ***Equity***

Insufficient capitalisation has been a contributing factor in recent failures. Abacus welcomes the proposed benchmark equity capital levels and the higher requirement for property related debenture issuers given the increased vulnerability of this market to changes in market conditions. We welcome consideration by ASIC of whether a higher benchmark would be more effective in creating a capital at risk incentive for sound management of the business and alignment of incentives and risks between debenture issuers and holders.

### ***Liquidity***

Abacus endorses proposals for liquidity benchmarks given mismatches in the timing of cash flows and market funding. We encourage ASIC to consider engagement with debenture issuers on a liquidity management strategy (along with a benchmark liquidity holding) for disclosure to the market. In terms of the quality of assets included in the liquidity benchmark, we suggest ASIC refer to APRA Prudential Standard 210 (paragraph 12) and APRA's view of high quality liquidity holdings for its regulated entities as a useful guide. We query whether the period for issuers to assess and report liquidity requirements be extended to six or twelve months (whilst accepting that three months may be a reasonable term for a cash or cash equivalents on hand benchmark).

### ***Loans***

Abacus supports improved disclosure by debenture issuers of LVRs with a differing benchmark for property related lending, and encourages ASIC assessment of underlying LVRs and LVRs in recent property-related debenture issuer failings in settling the final benchmark levels. Abacus supports information on loan quality/diversification. However, without disclosure of loan quality and arrears this information is incomplete and we recommend the inclusion of arrears reporting as part of ongoing market disclosure.

### ***Re-investment***

Abacus encourages ASIC to benchmark a positive obligation by the investor to continue in the debenture investment, and at a minimum, current disclosure at the time of any rollover for retail investors in mass-marketed unlisted property-related debentures.

### ***Credit Ratings***

Abacus supports ASIC's proposed rating benchmarks for the debenture market, but we emphasise that these are likely to be most effective for sophisticated investors. While we recognise ASIC's benchmark as a positive step, a reliance on credit ratings has the potential to create a simplistic impression of stability for unsophisticated investors, given the limited understanding of the role of credit ratings by the general public.

A more effective measure for the general market is to distinguish debenture issuers from APRA-regulated deposit products to ensure that investors clearly understand these are speculative investments operating outside the framework of rigorous prudential regulation.

Abacus cautions against external ratings becoming a de facto quality test where other measures (such as being a prudentially regulated ADI, in the case of retail deposits) may be more relevant for some investment promotions.

We note that most credit unions and mutual building societies, for example, do not obtain credit ratings. A credit rating is an opinion, purchased from an external agency, about a

company's creditworthiness for debt instruments. The reason for obtaining a credit rating is to gain access to capital and wholesale debt markets. Abacus members gain access to these markets via suppliers such as Cuscal Ltd.<sup>1</sup> Credit ratings from agencies are a means of assessing the creditworthiness of institutions for debt instruments. An 'A' rating from an agency such as Standard & Poor's is not focused nor based on any risk attached to deposits placed at ADIs, which are the subject of privileged treatment due to the depositor protection provisions in the *Banking Act 1959*.

Prudential standards and APRA's supervisory role distinguish ADIs from other institutions in the market. Mutual ADIs do not rely on wholesale markets for funding and do not need credit ratings for their deposit-taking activities. Of course, a deposit with an APRA-regulated ADI is one of the most secure and safe investment options available in the market and Abacus encourages ASIC to ensure this distinction is clear and well understood.

The risk of credit ratings, which themselves do not guarantee ongoing performance or provide additional regulatory oversight, being misinterpreted by unsophisticated investors requires further steps in disclosure measures for unlisted debentures. The use of credit ratings should be supplemented by the additional warnings proposed in this paper.

### **3. Ongoing disclosure and advertising**

Abacus endorses proposed ongoing disclosure and reporting obligations for debenture issuers, and recommends additional warning benchmarks for advertising (particularly for debenture investments relating to property financing). As noted above, credit unions and mutual building societies consider it essential that an investor warning section be mandated for both prospectus documents and advertisements which would highlight:

- (a) The investment is not protected by APRA supervision or prudential standards;
- (b) There is no guaranteed market for the securities and a redemption of the funds may not be possible when required;
- (c) An investment in this organisation is speculative in nature and all of the funds invested could be lost in the event of the failure of the organisation;
- (d) This investment is not similar in type, nature or prudential standing to that of a deposit made with a Credit Union, Building Society or Bank.

### **4. Application to APRA Regulated Entities**

APRA regulated entities, particularly those such as Authorised Deposit taking Institutions (ADIs) are subject to the highest international prudential standards in relation to their operations and reporting. Abacus is not aware of ADI involvement in the speculative property financing debenture market and prudential guidelines and inspection processes operate for the APRA-regulated sector. ASIC's proposals rightly target debenture issuers and particularly those operating in complex property financing investment vehicles.

Abacus strongly recommends that ASIC focus its measures on this market and avoid complicating the regime with unnecessary extension to prudentially regulated ADIs. Complexity could flow from, for example, accidentally capturing ownership instruments which underpin the mutual sector (eg member shares) which are fundamentally different instruments with no risk and are excluded by ASIC and international regulators from prospectus requirements. Should ASIC propose any extension of the benchmarks to APRA regulated entities Abacus seeks active consultation to avoid this complexity.

### **5. Ensuring advertising is accurate**

Clearly there is a substantial difference between prospectus disclosure and the advertisements run by such organisations in attempting to attract investments. While we support ASIC's proposed restricted terms, we suggest a more overt warning and message for advertising of unlisted debentures relating to property investment.

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<sup>1</sup> Cuscal Ltd is a wholesale provider of transactional banking services, liquidity and capital management products to more than 150 financial service retailers, including the majority of Australia's credit unions. Cuscal is an ADI and has a AA- long term credit rating with Standard & Poor's.

Advertising is more important than prospectus disclosure for this market. In many instances advertising will be the trigger for an investor to consider the placement of funds and the willingness of issuers to promote their investments as suitable for retirement funds and having a low risk profile requires more direct attention.

Another area of concern is the role of financial advisers and recommendations to retail investors which may be based on linked commissions and fail to promote diversification.

It is essential for the protection of consumers and to ensure that they do not misunderstand the nature of the investment, that advertisements for such debenture type instruments must not in any form be held out to be similar to a term deposit with an ADI.

Abacus also recommends, given the problems that have emerged from recent property group collapses, that ASIC consider a specific warning for DIY superannuation placement in this type of investment without independent advice.

Abacus believes that unsophisticated investors require more information about this speculative type of investment. In summary, Abacus is supportive of the proposals for unlisted debentures but recommends:

- Awareness that the benchmarks will not assist unsophisticated investors significantly;
- Additional, clearer warnings and alerts on risk and non-ADI status to address this gap;
- Caution against creating de-facto quality marks that do not reflect underlying risk;
- Maintaining a clear focus on the problematic areas of the market;
- Support for ongoing disclosure and additional advertising restrictions on set terms.

Abacus would be pleased to discuss our comments and the views of the mutual ADI sector in greater detail. Please contact me on (02) 8299 9046 or [lpetschler@abacus.org.au](mailto:lpetschler@abacus.org.au) or Philip Elliott at Abacus on (02) 8299 9050 or [pelliott@abacus.org.au](mailto:pelliott@abacus.org.au) for further information on the issues raised in this submission.

Yours sincerely



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