



**Abacus**  
Australian Mutuals

Association of Building Societies and Credit Unions

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Mr Anthony Graham  
Senior Specialist  
Corporations  
Australian Securities and Investments Commission  
[policy.submissions@asic.gov.au](mailto:policy.submissions@asic.gov.au)

Dr Mr Graham,

### **Consultation Paper 126 Facilitating debt raising**

*Abacus – Australian Mutuals* appreciates the opportunity to comment on the proposals in ASIC Consultation Paper 126.

Abacus is the industry body for customer-owned financial institutions, representing 105 credit unions, 9 mutual building societies and 25 friendly societies. Our member institutions serve 6 million Australians and hold total assets of \$70 billion.

Credit unions and mutual building societies are public companies under the *Corporations Act 2001* and Authorised Deposit-taking Institutions (ADIs) regulated by APRA under the *Banking Act 1959* and provide a full range of consumer banking services. Friendly societies provide investment and insurance services to members to assist in planning for life events. Most societies are registered under the *Life Insurance Act 1995* and regulated by APRA.

Abacus supports action to promote a retail bond market because:

- corporate bonds are attractive to certain retail investors, including retirees and those nearing retirement;
- it offers the opportunity for companies, including Abacus members, to diversify their funding and capital base; and
- "a more diversified and liquid bond market would benefit Australia's domestic economy and could over time assist Australia in playing a larger role in the region."<sup>1</sup>

Abacus supports allowing certain offers of 'vanilla' corporate bonds to be made to retail investors under a simplified prospectus. Class order relief is preferable to case-by-case relief.

ASIC's key considerations - i.e. to maintain standards of consumer protection; to expand suitable investment opportunities for retail investors; and, to develop a

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<sup>1</sup> *Australia as a Financial Centre: Building on Our Strengths* Report by the Australian Financial Centre Forum, Nov 2009

quoted debt market – can be accommodated with a more flexible approach than that currently proposed.

Abacus seeks modifications to the proposals to allow unlisted prudentially-regulated mutual organisations access to the relief framework.

There is proven demand for listed debt issues by mutual ADIs. Heritage Building Society raised \$50 million in 2009 from the issue of 500,000 subordinated debt securities quoted on the ASX. The demand for Heritage Notes was extremely strong, with the Notes being more than three times oversubscribed. Australian Central Credit Union issued ASX-listed subordinated unsecured notes in 2000.

Listed debt could be a valuable option for other mutual ADIs seeking to diversify their funding and capital base.

However, barriers to participation by mutual ADIs and friendly societies in the current relief framework proposed by ASIC include:

- requirement for the entity to be listed;
- aggregate size of the bond issue must be at least \$100 million;
- bonds are not subordinated

#### **Prudential standing of unlisted ADIs**

Abacus notes ASIC's "key assumption" that issuers, due to having their equities listed, will have already provided the market with relevant information through their annual financial report, half-yearly financial report and subsequent continuous disclosure notices.

However, retail investors in listed debt issued by unlisted mutual ADIs can have the confidence that they are investing in a sector that is subject to the most effective prudential regulatory regime in the world.

APRA's prudential regulatory regime involves rigorous supervision and legally-enforceable prudential standards on capital, liquidity, risk management and governance. These standards do not apply to other companies that may wish to issue corporate bonds to retail investors.

Under the prudential standards, ADIs must maintain an appropriate level and quality of capital commensurate with the level and extent of their risks. An ADI must have in place adequate systems and procedures to identify, measure, monitor and manage its risks on a continuous basis to ensure that capital is held at a level consistent with its risk profile.

ADIs must maintain a liquidity management strategy that is appropriate for its operations to ensure that it has sufficient liquidity to meet its obligations as they fall due.

Under Prudential Standard APS 330 *Capital Adequacy: Public Disclosure of Prudential Information*, mutual ADIs must publicly disclose on a quarterly and annual basis information on capital position, capital adequacy and credit risk, including bad debt statistics.

In addition to the standards on capital and liquidity, APRA imposes legally enforceable prudential standards covering:

- **Business Risks:** Credit risk is to be managed through good lending practices, to minimise delinquencies and write-offs, and by appropriate provisioning for bad debt. Market risk (interest rate risk) exposures for loans and deposits must also be managed to protect portfolios and interest margins. Concentration risks in large exposures (for credit and investments) and contagion risk from related entities (e.g. subsidiaries), both need to be identified and minimised.

- **Operational Risk:** Operational risk must be identified and managed across the whole business of an ADI including: data risk; insurable risks (e.g. physical assets and workers compensation); the outsourcing of key functions to third parties; and potential business disruptions (threats to business continuity). These risks require close monitoring, clear processes and planning to avoid losses.

- **Audit and Disclosure:** ADIs must implement an independent and transparent external audit process, supported by robust internal audit and effective board oversight. Compliance with Prudential Standards must be reviewed by external auditors and attested to by directors and the chief executive.

- **Governance:** Sound and prudent governance is required to maintain public confidence and deliver benefits to stakeholders. Clear strategic direction by boards, together with professional management from executives, incorporating contemporary risk management practices, is demanded. Directors and senior managers must meet high standards of competence and integrity ('fitness and propriety'). Board oversight of risk management and financial performance is central to good governance. Remuneration policies and oversight arrangements that promote the long-term financial soundness of the institution must be in place.

Non-ADIs that may wish to issue retail bonds are not subject to this stringent regulatory framework.

Mutual ADIs have a strong record of complying with the prudential standards.

Throughout the turbulence of the global financial crisis, no credit union or building society breached APRA's prudential capital requirements or, for that matter, any other key prudential requirements.

This performance was confirmed by APRA chairman Dr John Laker at the 2009 Abacus Convention: "Behind these facts lies the ongoing strength of the simple business model of mutual ADIs — a model built on high standards of customer service, conservative lending standards in traditional markets and strong liquidity and capital buffers."<sup>2</sup>

The prudential framework is already recognised for the purposes of disclosure laws in the *Corporations Act 2001*. Under section 708(19), an offer of ADI debentures does not need disclosure to investors under Part 6D.2.

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<sup>2</sup> *Mutuals after turbulent times* John Laker, APRA 9 Nov 2009.

### **Reduce prescription**

Abacus recommends that the relief should accommodate subordinated debt securities issued by unlisted mutual ADIs, with no minimum subscription size, or if there must be a minimum it should be \$10 million rather than \$100 million. Restricting the relief to offers of at least \$100 million would be likely to exclude most, if not all, mutual ADIs from participating.

Abacus recommends that in finalising the relief ASIC should aim to minimise complexity and prescription. The number of conditions and restrictions attaching to the relief should be considerably reduced. The requirement for quarterly reports as set out in section 2(c) of the proposed vanilla bonds prospectus should be removed. This requirement is unnecessary because once an issuer's debt is listed, the issuer will have continuous disclosure obligations. ASX listing rule 3.1 says: "Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information."

I can be contacted on 02 6232 6666 or at [llawler@abacus.org.au](mailto:llawler@abacus.org.au) to discuss any aspect of this submission.

Yours sincerely,



**LUKE LAWLER**  
Senior Adviser, Policy & Public Affairs