Global Credit Investors Pty Ltd | ABN 68 140 364 576 | AFSL 346034
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6 January 2012

Manager,
Financial Services Unit,
Retail Investor Division,
The Treasury,
Langton Crescent,
Parkes, ACT, 2600.

Dear Sir / Madam,

SUBMISSION IN RESPONSE TO THE DISCUSSION PAPER - DEVELOPMENT OF THE RETAIL CORPORATE BOND MARKET: STREAMLINING DISCLOSURE AND LIABILITY REQUIREMENTS

Global Credit Investors Pty Ltd (GCI) provides financial services to larger wholesale fixed interest investors with our specialisation the assessment of credit risk and reward.

We provide the following comments on questions under the following headings within the above mentioned discussion paper.

PROPOSED APPROACH

Tailoring / replacement of current prospectus rules

A single simplified prospectus is preferred by us and to standardise documentation we think it should be compulsory. As such we recommend only very simple instruments be issued and we elaborate on this in the following discussion.

Proposed entry requirements / eligibility – conditions related to the issuer

The proposed conditions are appropriate.

Unlisted entities should not be able to use a shorter prospectus to issue listed bonds.

Eligibility should extend to any issuing subsidiary only where there is a guarantee from the listed parent.

The requirement for the unmodified auditor's report is unnecessary for the reasons stated in the discussion paper.

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Proposed entry requirements / eligibility – conditions relating to the bond

- The bond should be denominated in AUD;
- Be for a fixed term with a bullet or certain maturity with an event of default triggered if principal is not repaid. There should be a clear course of action if principal is not repaid on time, e.g. via a security trustee taking control of the process;
- Interest may be capitalised or paid periodically;
- Interest rates and their method of calculation should in our opinion be set at issue in the following ways:
  - Fixed interest rate bonds
    - the market component of the interest rate is set at issue and fixed until maturity and
    - the market component of the credit risk premium is set at issue and fixed until maturity;
  - Floating interest rate bonds
    - the market component of the interest rate is set at issue for a specified period, usually 1 to 6 months, and reset thereafter for the same period until the maturity of the bond.
    - the market component of the credit risk premium is set at issue and fixed until maturity;
- There should be no capacity for the fixed credit risk premium to change after issue for either fixed or floating rate securities as it would add too much complexity to the bond;
- Calculations for any capitalising interest need to be clear and certain at issue with no discretion given to the issuer;
- The non payment of a coupon needs to constitute an event of default with a clear course of action for the investors via, for example, a security trustee;
- The bond can be subordinated or unsubordinated;
- The bond should not be convertible into any other security;
- Minimum issue amount? No opinion;
- There should be no maximum term;
- Risk disclosure of the impact of subordination, longer maturity dates and varying credit quality of issuers needs to be disclosed (see discussion on 'Detailed Contents' s.5 below).

Use and availability of credit ratings

- There is no need for a credit rating for an issuer of a bond or frn. Bond investors will assign a credit risk premium appropriate for the investment, as equity investors do when assigning an equity risk premium to share valuations. Bond investors, like

equity investors, will form their own opinion on the quality of the issuer. There are many investment advisers, planners, research houses, institutions and individuals who are capable of assessing the credit quality of an investment and the required credit risk premium;

- It would be worth considering limiting the use of a shorter issue document to the top ASX 100 companies in the initial years. While higher market capitalisation does not always mean higher credit quality it generally does;
- Bond indices could be developed for bonds issued by ASX 50 and ASX 100 companies, provided the bonds or frns are listed on the ASX. This would encourage the development of the market;
- Down the track ASX 300 and ASX 500 companies could issue under the shorter prospectus. Being able to issue does not mean they will issue as investors may show no interest in bonds from certain companies at the credit risk premium on offer, which is the same situation as exists between issuers and investors in the equity markets;
- Equity investors in a company switching into that company's bonds will be taking less risk. Cash investors buying bonds will generally be increasing their risk and risk disclosures will need to include some quantification of this potential risk. More discussion on this below (see discussion on 'Detailed Contents' s.5 below).

General approach to content requirements and prospectus length

Prescribed headings and a maximum length would help standardise the market.

CONTENT REQUIREMENTS

Prescribed headings / sections and investment overview

Headings set out in paragraph 41 are generally fine. An investment summary would be useful.

Detailed contents

Section 1: Should provide at least a few weeks for investors to assess the bond issue.

Section 2: A brief description of the issuing entity and a declaration that the issuing entity is the listed entity or guaranteed by the listed entity would be needed (based on our recommendations above that only listed entities be allowed to issue bonds). The purposes to which the money will be put is a key piece of information.

Section 3: OK.

Section 4: OK. As discussed, we recommend only allowing bonds that pay regular, non-deferrable coupon payments and that have a fixed maturity. Section 4 could be merged with section 3.

Section 5: A key section where a quantification of the potential capital gain / loss or income gain / loss should be set out.

Two key risks for investors are i) temporary loss from mark to market capital price movements

and ii) loss from default.

Temporary loss from mark to market price movements:

We think the following scenarios should be set out in a prospectus for bond issues:

The bond should be re-priced based on -

a) Base market interest rate i) increasing or ii) decreasing by 2% the day after issue.
b) Credit risk premium i) doubling or ii) halving the day after issue.

For fixed rate bonds:

A fixed rate bond has a fixed base market interest rate to maturity and a fixed credit risk premium to maturity. Four values / prices need to be calculated for the capital price of the bond under the four scenarios by moving one variable and keeping the others constant.

Doing this will highlight the increasing potential volatility of capital value the longer the maturity, the weaker the credit and the lower the ranking of the security (in the case of sub debt).

There is no need to state the likelihood of each scenario happening as this is an assessment to be made by the investor. The mark to market measures allow traditional cash investors to understand the risks of investing in corporate bonds, especially as term to maturity increases.

It should also be stated that income will not vary as the payments from the bond are fixed until maturity.

For floating rate bonds

A floating rate bond has a floating base market interest rate (or a short fixed rate), usually for a resetting term of between 1 and 6 months, and a fixed credit risk premium to maturity. Again, four values need to be calculated for the four scenarios.

If base market interest rates rise or fall by 2% capital price impact will be minimal but income will potentially increase or decrease by 2% and this need to be explained.

Credit risk premium impacts will be the same for an FRN as for a fixed rate bond.

Again there is no need for an issuer to state the likelihood of a scenario happening.

It should be stated that if the issuer does not default any capital gains and losses will reverse by maturity and the investor will be left with his coupons over the term of the investment as his return on investment. At maturity the investor will get his investment

back.

It should be stated that base interest rates and credit risk premiums can move based on such things as changes in the economic outlook generally and the credit quality of an issuer.

The risk of loss from default

This needs to be highlighted as another key risk. However an investor will assess this risk and assign their own measures as part of their due diligence as mentioned previously. Most, if not all, of the information available to an investor to assess issuer loss risk will come from the information supplied elsewhere under the current reporting obligations.

The potential volatility and credit quality of the investment are ultimately inputs by the investor into the calculation of a credit risk margin.

Section 6: There is no need for any ratios or forecasts on capacity to meet obligations. Investors will have their own method of calculating ratios. As with credit ratings, an issuer can chose to include any information they think will market the bonds more effectively.

It would be important to know if any material covenants or obligations had been breached two years prior to the issue.

Sections 7 to 10: No comments

USING A MULTI-PART PROSPECTUS

We would prefer a single simplified maximum length prospectus

INCORPORATION OF INFORMATION BY REFERENCE

We have no opinion on detail but incorporation by reference is fine in principle.

LIABILITY FOR PROSPECTUS CONTENT

No specific opinion, although our recommendations should reduce the risk for issuers.

EXEMPTION FOR PRUDENTIALLY REGULATED ENTITIES

We recommend you remove the exemption and level the playing field. At the very least the mark to market risk potential of the bonds needs to be conveyed to investors as mentioned above. The shorter prospectus will in our opinion be more about the instrument being issued and not the issuer. The prudential oversight may reduce loss from default risk but won’t eliminate mark to market risk, the key risk to investors in bonds.

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APPLICATION AND TRANSITIONAL ARRANGEMENTS

Under our recommendations we don’t think there is any need for a transitional period.

Please contact us at any time and thank you for the opportunity to provide some feedback,

Yours Faithfully,

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David Bickford

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