

Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 Written Questions on Notice – ASIC – January 2017

1. Hybrid Securities

During the last round of Senate Estimates, former head of ASIC Mr Greg Medcraft raised a number of concerns about sales of hybrid securities to retail investors (page 30 of Treasury Estimates Thursday 26 October)

- a. Can you confirm that hybrid securities sold by authorised ADIs and insurers that comply with either Tier 1 or Tier 2 capital requirements could be subject to write-down or write-off under this bill?

Answer:

Please refer to the response provided in the Treasury QoN response.

- b. Of the reported \$43.3 billion of hybrid securities that exist as of June 2017, can you provide breakdowns by:
 - i. How much was issued by Authorised ADIs and complies with Tier 1 or Tier 2 capital requirements?

Answer:

Please refer to the response provided in the Treasury QoN response.

- ii. How much was issued by insurers and complies with Tier 1 or Tier 2 capital requirements?

Answer:

Please refer to the response provided in the Treasury QoN response.

- iii. Of 1(b)(i) – how much is held by retail investors or SMSFs (both total value and average/median value held per owner)

Answer:

Please refer to the response provided in the Treasury QoN response.

- iv. Of 1(b)(ii) – how much is held by retail investors or SMSFs (both total value and average/median value held per owner)

Answer:

Please refer to the response provided in the Treasury QoN response.

- v. What disclosure requirements are required before a retail investor or SMSF can invest in such a security? Are there requirements for disclosure of risks, including the risk of conversion or write-off should the issuer become insolvent?

Answer:

Offers of hybrid securities are subject to the disclosure obligations under the Corporations Act 2001 (Cth) (Act). Almost all offers of hybrid securities to retail investors are made using a prospectus, which must be lodged with ASIC, and is then subject to review for compliance with the Act.

A prospectus must contain all the information that investors (and their professional advisers) would reasonably require to make an informed assessment of:

- **the rights and liabilities attaching to the securities offered [in this case, the hybrid securities]**
- **the rights and liabilities attaching to any securities into which those hybrid securities may convert [in this case, ordinary shares in the bank or insurer who is issuing the hybrid]; and**
- **the effect of the offer on the issuing body [the bank or insurer]: section 713, as notionally modified by ASIC Corporations (Regulatory Capital Securities) Instrument 2016/71.**

A prospectus is also required to be clear, concise and effective: section 715A. ASIC has provided guidance on how it reviews prospectuses, as well as the kinds of information it expects to see: Regulatory Guide 254 Offering securities under a disclosure document and Regulatory Guide 228 Prospectuses: Effective disclosure for retail investors (RG 228). ASIC has also made specific comments on prospectus disclosure for hybrid securities in Report 365 Hybrid securities (REP 365).

The prospectus content requirements in the Act, together with our regulatory guidance, require disclosure of risks:

- **relevant to the securities being offered (including the risk of conversion or write-off should the issuer become insolvent); and**
- **relevant to the issuer itself.**

However, hybrid securities are complex products and, like many such products, they test the limits of a disclosure-based regulatory regime. In recognition of this, for a period of approximately 3 years beginning in late 2012, ASIC departed from its usual practice of reviewing disclosure documents only after lodgement, and engaged with issuers of hybrid securities and their advisers prior to lodgement of the prospectus, providing comments on draft documents. This was done with the particular aim of improving the clarity of disclosure for retail investors, and to reflect the guidance set out in RG 228 and our comments in REP 365. ASIC ceased this practice once market-standard disclosure began to emerge, and as the results of our pre-lodgement review identified that limited additional changes could be made to further improve the clarity of disclosure given the complexity of the hybrid securities in question.

ASIC notes that the Act allows for offers of hybrid securities to be made using an offer information statement (OIS) where the amount of money to be raised does not exceed \$10 million: section 715. An OIS contains limited information prescribed by the Act, and ASIC does not have the power to preclude the use of an OIS where it considers the more fulsome disclosure required by a prospectus would be desirable. The ability to use an OIS was introduced by the Corporate Law Economic Reform Program Act 1999 (CLERP Act) for the purposes of promoting and encouraging fundraising for small-to-medium size enterprises: see Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998, para 8.6.

ASIC is only aware of one offer of hybrid securities made using an OIS, which sought to raise less than \$10 million. The issuer, a credit union, provided risk

disclosure addressing both the risk of conversion and the risk of write-off should the issuer become insolvent.

2. Has ASIC raised the concern about retail sales of hybrid securities to either Treasury or the Government? Has ASIC recommended a ban of these sales to retail investors or SMSFs? If so, what was the response from Treasury or Government?

ASIC has not specifically raised concerns about retail sales of hybrid securities to either Treasury or the Government, nor has ASIC recommended a ban of these sales to retail investors or SMSFs.

However, ASIC has considered whether its current tools are sufficient to address the risks posed to retail investors by complex products (which include hybrid securities), and what other approaches could be adopted to improve investor outcomes.

ASIC examined its approach to complex products through a dedicated Complex Products Working Group. Report 384 Regulating complex products, published in January 2014, set out the way ASIC uses its current powers at each stage of the 'product lifecycle', and identified opportunities for further work within these existing powers.

ASIC has also examined its regulatory toolkit and considered whether it is sufficient to address the risks posed to retail investors by complex products. ASIC has identified further powers that would help it ensure investors are confident and informed, and advocated for these in its submissions to the Financial System Inquiry, and the Government's response to the FSI seeking feedback on the introduction of Design and Distribution Obligations and a Product Intervention Power. If the proposed Product Intervention Power becomes law, it would enable ASIC to take direct action to deal with significant shortcomings in products or conduct that result in consumer detriment, although no decision has been made by ASIC that such a power would be used to restrict the sale of hybrid securities to retail investors or SMSFs.