

# Chapter 2

## Schedule 1—Simple corporate bonds

2.1 This chapter begins with an overview and background on the operation of Schedule 1 of the bill, followed by submitters' views on the proposed amendments.

2.2 As noted in the previous chapter, Schedule 1 amends the disclosure regime for simple corporate bonds, changes directors' civil liability provisions in respect to simple corporate bonds issued to retail investors, and clarifies the application of directors' defences in respect to misleading and deceptive statements and omissions in disclosure documents relating to offers of all securities.

2.3 Schedule 1, Part 1 of the bill would amend the Corporations Act by:

- introducing a new disclosure regime;
- facilitating parallel trading between wholesale and retail markets; and
- changing the civil liability provisions in respect to corporate bonds issued to retail investors.

2.4 Schedule 1, Part 2 of the bill proposes amendments to the 'reasonable steps' obligations relating to false or misleading statements.

### Background and context of the amendments

2.5 The requirements for issuing corporate bonds into the retail market differ from those pertaining to the wholesale market in terms of both disclosure and liability provisions.

2.6 A retail corporate bond is a bond that is issued to investors that include retail clients. A wholesale corporate bond issue excludes retail investors.<sup>1</sup>

2.7 The wholesale market caters to sophisticated professional investors. Under the Corporations Act, listed entities are required to adhere to a regime of continuous disclosure<sup>2</sup> under Listing Rule 3.1 and 3.1A.

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1 The Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011, p. 4, [http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2011/Development%20of%20the%20Retail%20Corporate%20Bond%20Market%20Streamlining%20Disclosure%20and%20Liability%20Requirements/Key%20Documents/PDF/Retail\\_Corporate%20Bonds\\_DP.ashx](http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2011/Development%20of%20the%20Retail%20Corporate%20Bond%20Market%20Streamlining%20Disclosure%20and%20Liability%20Requirements/Key%20Documents/PDF/Retail_Corporate%20Bonds_DP.ashx) (accessed 9 April 2013).

2 *Corporations Act 2001*, ss. 674(2).

2.8 Listing Rule 3.1 is given statutory force in subsection 674(2) of the Corporations Act and is policed by the Australian Securities Exchange (ASX) and the Australian Securities and Investments Commission (ASIC). Entities are liable for both criminal and civil penalties if they breach Listing Rule 3.1. Officers of the entity have civil liability for a breach of continuous disclosure under subsection 674(2A) of the Corporations Act. Criminal liability may also be incurred under section 1309 of the Corporations Act if an officer or employee 'gives, or authorises or permits the giving of, materially false or misleading information to ASX under Listing Rule 3.1'.<sup>3</sup>

2.9 Under the continuous disclosure regime, sophisticated investors are deemed to have sufficient information and possess sufficient resources to evaluate investments. Consequently, there is no requirement for an entity wishing to issue bonds into the wholesale market to prepare a disclosure document.<sup>4</sup>

2.10 By contrast, the Corporations Act currently requires that an entity wishing to issue bonds into the retail market prepare a full disclosure document or prospectus. A full prospectus must disclose:

...all of the information that investors and their professional advisors may reasonably require to make an informed assessment of:

- the rights and liabilities attaching to the securities offered; and
- the assets and liabilities, financial position and performance, profits and losses and prospects of the body that is to issue the securities.<sup>5</sup>

2.11 The Corporations Act contains provisions relating to both civil and criminal liability in relation to false and misleading statements and omissions from documents. The civil liability regime is laid out in Chapter 6D of the Corporations Act and criminal liability is covered in Part 9.4 of the Corporations Act.

2.12 Section 728 of Part 6D.3 of the Corporations Act details the civil liability offences relating to a misleading or deceptive statement in, or omission from, a disclosure document.<sup>6</sup> Section 729 of the Corporations Act sets out those persons who may be liable for compensation in the event of a misstatement in, or omission from, a disclosure document. This includes all current and proposed directors of the entity. Furthermore, a person who suffers loss or damage because of a contravention in a disclosure document is able to claim compensation against a director for loss or

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3 ASX, ASX Listing Rules—Continuous Disclosure: An Abridged Guide, p. 1, <http://www.asx.com.au/documents/about/abridged-continuous-disclosure-guide-clean-copy.pdf> (accessed 24 April 2013).

4 *Corporations Act 2001*, ss. 708(10).

5 *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, p. 6.

6 *Corporations Act*, s. 728.

damage even if the director 'did not commit, and was not involved in, the contravention'.<sup>7</sup>

2.13 Sections 1308 and 1309 of Division 1 of Part 9.4 of the Corporations Act deal with offences that are subject to the *Criminal Code* relating to false or misleading statements<sup>8</sup> and false information, respectively.<sup>9</sup>

2.14 The Corporations Act provides defences in relation to both civil and criminal liability for a misstatement or omission in a disclosure document. Section 731 of the Corporations Act sets out the due diligence defence for prospectuses<sup>10</sup> and provides that:

a person will not be liable because of a misleading or deceptive statement in a prospectus or an omission from a prospectus if a person can prove that:

- they made all inquiries (if any) that were reasonable in the circumstances; and
- after doing so believed, on reasonable grounds, that the statement was either not misleading or deceptive or that there was no omission from the prospectus in relation to a particular matter.<sup>11</sup>

2.15 In November 2009, the Australian Financial Centre Forum chaired by Mr Mark Johnson released a report titled *Australia as a Financial Centre: Building on our strengths*. The Johnson report identified the lack of liquidity and diversity in Australia's corporate bond market as a weakness in Australia's financial system. To assist in the development of the retail corporate bond market, the Johnson report recommended a reduction in regulatory requirements on corporate debt issuance to retail investors.<sup>12</sup> Reducing these regulatory requirements is the focus of the bill.

2.16 In December 2010, the Government announced the *Competitive and Sustainable Banking System* package. The Government identified the bond market as a key element of the long-term safety and sustainability of the financial system and pointed to the need to:

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7 *Corporations Act*, s. 729.

8 *Corporations Act*, s. 1308.

9 *Corporations Act*, s. 1309.

10 *Corporations Act*, s. 731.

11 *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, pp 6–7.

12 Australian Financial Centre Forum, *Australia as a Financial Centre: Building on our strengths*, November 2009, Recommendation 4.6, p. 96.

develop a deep and liquid corporate bond market by launching the trading of Commonwealth Government Securities on a securities exchange, to reduce our reliance on offshore wholesale funding markets.<sup>13</sup>

### *Treasury consultation*

2.17 In December 2011, Treasury released a discussion paper on the development of the retail corporate bond market in Australia. It considered the optimum disclosure and liability requirements.<sup>14</sup>

2.18 The Treasury discussion paper observed that when Australian companies wish to obtain funding, they either:

- access overseas debt markets (generally the United States, the United Kingdom and Europe);
- borrow from the Australian wholesale market;
- borrow from Authorised Deposit-taking Institutions; or
- issue equity (for example, shares or rights) or issue some combination of debt and equity (for example, hybrids or convertible bonds).<sup>15</sup>

2.19 Treasury noted that because medium and small companies rarely have access to foreign or domestic wholesale debt markets, they are restricted to bank borrowing or issuing equity. However, when overseas and wholesale markets tighten, raising funds becomes difficult. Treasury further noted that 'the United States, and to a lesser extent New Zealand and the United Kingdom, all have thriving retail corporate bond markets' and that Australian companies of all sizes would benefit from the development of the retail corporate bond market.<sup>16</sup>

2.20 Treasury also found that the current disclosure regime for retail bonds is 'costly and onerous' for companies,<sup>17</sup> and that the length and complexity of the document may deter retail investors from considering retail bonds.<sup>18</sup>

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13 The Hon. Wayne Swan, Treasurer, 'A Competitive and Sustainable Banking System', Media release, <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/091.htm&pageID=003&min=wms&Year=&DocType> (accessed 12 April 2013).

14 The Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011.

15 The Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011, p. 2.

16 The Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011, p. 2.

17 The Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011, p. 2.

18 The Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011, p. 3.

### *Retail trading in Commonwealth Government Securities*

2.21 Professional investors are able to trade in Commonwealth Government Securities (CGS) in over-the-counter markets.<sup>19</sup> In 2012, Parliament passed the Commonwealth Government Securities Legislation Amendment (Retail Trading) Bill 2012. The legislation was designed to enable retail trading in CGS depository interests<sup>20</sup> on the public exchange in order to foster the development of the retail debt market, including corporate debt.<sup>21</sup> ASIC expected that retail trading of CGS would commence in April 2013.<sup>22</sup>

2.22 In his Second Reading Speech to Parliament on the Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, the Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, noted that the retail market in CGS was a valuable precursor to the retail bond market:

Having an active retail CGS is an important step in establishing a wider retail corporate bonds market by providing a visible pricing benchmark for retail investors in corporate bonds.<sup>23</sup>

### *ASIC Class Order 10/321 and 'vanilla' corporate bonds*

2.23 The disclosure requirements for simple corporate bonds were modified prior to the current bill to incorporate a two-part prospectus.

2.24 In May 2010, ASIC introduced Class Order 10/321 specifying the criteria for 'vanilla' corporate bonds. A 'vanilla' bond is a low-risk bond with relatively

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19 The Australian Securities and Investments Commission (ASIC), 'ASIC finalises regulatory framework for retail trading of Commonwealth Government Securities', Media release 13-065, 27 March 2013, <http://www.asic.gov.au/asic/asic.nsf/byheadline/13-065MR+ASIC+finalises+regulatory+framework+for+retail+trading+of+Commonwealth+Government+Securities?openDocument> (accessed 26 April 2013).

20 ASIC defines depository interests in CGS as beneficial interests in the underlying security that provide the holder with the same economic rights as if they were the legal holder of the CGS. The Australian Securities and Investments Commission (ASIC), 'ASIC finalises regulatory framework for retail trading of Commonwealth Government Securities', Media release 13-065, 27 March 2013.

21 *Explanatory Memorandum (EM)*, Commonwealth Government Securities Legislation Amendment (Retail Trading) Bill 2012, p. 5; *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, p. 5.

22 The Australian Securities and Investments Commission (ASIC), 'ASIC finalises regulatory framework for retail trading of Commonwealth Government Securities', Media release 13-065, 27 March 2013.

23 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, *Second Reading Speech*, House of Representatives, 20 March 2013, [http://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansardr/8143f75e-7f37-4128-8d3b-e62455d99a32/0063/hansard\\_frag.pdf;fileType=application%2Fpdf](http://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansardr/8143f75e-7f37-4128-8d3b-e62455d99a32/0063/hansard_frag.pdf;fileType=application%2Fpdf) (accessed 10 April 2013).

straightforward terms and conditions, and no unusual features. The committee heard from Dr Richard Sandlant, Manager of the Disclosure and International Unit at the Treasury, that 'vanilla' bonds were synonymous with simple corporate bonds.<sup>24</sup> In its Class Order, ASIC defined a 'vanilla' corporate bond as a debenture of a body that:

- is denominated in Australian dollars;
- has a fixed term of no more than 10 years, with the principal plus any accrued interest payable at the expiry of the term;
- may provide for redemption prior to the expiry of the fixed term in certain circumstances;
- has a floating rate of return that comprises a reference rate plus a fixed margin or a fixed rate of return;
- provides for interest to be paid periodically on specified dates;
- is not subordinated under the terms of the debenture to any debt owing to unsecured creditors of the body;
- is not convertible into another class of securities; and
- is issued at the same price as all other debentures issued under the prospectus for the debenture.<sup>25</sup>

## **Main provisions of Schedule 1: Part 1—Amendments relating to simple corporate bonds**

### *Two-part prospectus for simple corporate bonds*

2.25 The bill's amendments to the Corporations Act would provide a new disclosure regime for the offer of simple corporate bonds. This will require a body corporate to issue a two-part simple corporate bond prospectus consisting of a base prospectus and an offer-specific prospectus.<sup>26</sup> Although the Corporations Act will contain the framework and eligibility criteria for the two-part prospectus, the content and structure will be specified by regulations.<sup>27</sup>

2.26 The two-part prospectus includes a base part that is valid for three years and an offer-specific part that is valid for the period of the offer. The EM describes the structure of the two-part prospectus as follows:

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24 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 10.

25 Australian Securities and Investments Commission (ASIC), *Explanatory Statement*, ASIC Class Order [CO 10/321], pp 5–6, <http://www.asx.com.au/documents/professionals/co10-321.pdf> (accessed 10 April 2013).

26 *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, p. 9.

27 *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, p. 7.

- Base: the base part would have a life of three years. The base prospectus will have general information about the issuer and the issue that is unlikely to change significantly over three years. Issuers will have the option of releasing a base prospectus in anticipation of making an actual offer of bonds. Issuers will not generally need to update the base document.
- Offer-specific: for each fund raising tranche, issuers will need to release a second document outlining the key details of the offer, that being the offer-specific prospectus. The offer-specific prospectus will have similarities with the cleansing notice regime for other offerings, whereby it will include a statement outlining that the issuer has complied with their continuous disclosure obligations. Issuers will need to disclose in the second part any matters material to a consideration of an investment in the bonds that have not already been the subject of continuous disclosure.<sup>28</sup>

2.27 Under the proposed section 713A, the bill sets out the criteria that simple corporate bonds must meet in order to qualify for the new streamlined disclosure regime:

- The securities must be debentures as defined in section 9 of the Corporations Act. *[Schedule 1, item 22, subsection 713A(2)]*
- The securities must be quoted on a prescribed financial market. *[Schedule 1, item 22, subsections 713A(3) and (4)]*
- The securities must be denominated in Australian currency. *[Schedule 1, item 22, subsection 713A(5)]*
- The fixed term of the securities cannot exceed 10 years. *[Schedule 1, item 22, subsection 713A(6)]*
- The principal and any accrued interest must be repaid to the holder at the end of the fixed term of the security. *[Schedule 1, item 22, subsection 713A(7)]*
- The interest rate must be either a fixed or floating rate. A floating rate is comprised of a reference rate (to which the issuer has no direct control) and a fixed margin set by the issuer. *[Schedule 1, item 22, subsection 713A(8)]*
- The securities can be subject to an increase in the fixed rate or the fixed margin in respect to the interest payable but cannot be subject to a decrease in the interest payable. *[Schedule 1, item 22, subsections 713A(9) and (10)]*
- Interest payments under the security must be paid periodically and cannot be deferred or capitalised by the issuing body. *[Schedule 1, item 22, paragraphs 713A(11)(a), (b) and (c)]*
- The face value for the security cannot exceed \$A1000. *[Schedule 1, item 22, subsection 713A(12)]*

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28 *Explanatory Memorandum (EM), Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, p. 8.*

- Securities can only be redeemed prior to the end of the fixed term in specified circumstances. [*Schedule 1, item 22, subsection 713A (13)*]
- Debt to security holders is not subordinated to debts to unsecured creditors. [*Schedule 1, item 22, subsection 713A(14)*]
- The securities must not be able to be converted into another class of securities. [*Schedule 1, item 22, subsection 713A(15)*]
- The price payable for the securities must be the same for all persons who accept the offer. [*Schedule 1, item 22, subsection 713A(16)*]
- The body offering the securities must have continuously quoted securities, or is a wholly owned subsidiary of a body corporate that has continuously quoted securities. [*Schedule 1, item 22, subsections 713A(17) and (18)*]
- The most recent auditor's report on the most recent financial statements must not have been modified. [*Schedule 1, item 22, subsections 713A(19) and 713A (20)*]<sup>29</sup>

2.28 A two-part prospectus must be lodged with ASIC. ASIC has the power to determine whether the proposed offer meets the criteria for a simple corporate bond.<sup>30</sup>

2.29 In order to streamline the process for issuers, reduce the length of the offer-specific prospectus and increase its readability, information in the offer-specific prospectus can be incorporated by cross-reference to the information contained in the base prospectus lodged with ASIC.<sup>31</sup>

2.30 A supplementary or replacement document may be lodged with ASIC if the issuer becomes aware of a misleading or deceptive statement in, or an omission from, the two-part prospectus.<sup>32</sup>

### ***Parallel trading of simple corporate bonds***

2.31 Under the bill, simple corporate bonds can be issued directly into the retail market through the ASX. However, there are also provisions to allow simple corporate bonds to be traded on the ASX as depositary interests in a similar fashion to the way foreign shares and CGS are currently traded on the ASX.

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29 *Explanatory Memorandum (EM), Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013*, pp 11–14; *Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013*, pp 7–12.

30 *Explanatory Memorandum (EM), Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013*, p. 14.

31 *Explanatory Memorandum (EM), Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013*, p. 18.

32 *Explanatory Memorandum (EM), Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013*, p. 19.

2.32 In order to facilitate parallel trading of simple corporate bonds in the wholesale and retail markets, the bill proposes the same depositary interests mechanism that already exists for retail trading of CGS. Depositary interests 'provide retail investors with a beneficial ownership in an underlying security' and would allow simple corporate bonds in the wholesale market to be offered to retail investors.<sup>33</sup>

2.33 A depositary nominee—that is, the person who issues beneficial interests to another party—can only issue these interests with the agreement of the issuing body. The disclosure obligation is that required by the issuer of the simple corporate bond (the underlying asset) in the two-part prospectus.<sup>34</sup>

2.34 The EM notes that in addition to amending the Corporations Act to facilitate parallel trading of simple corporate bonds, further regulatory changes will be needed to ensure that all relevant requirements can be met.<sup>35</sup>

### ***The removal of 'deemed liability' for directors***

2.35 The EM notes that section 728 of the Corporations Act:

prohibits a person from offering securities under a disclosure document if, among other things, there is a misleading or deceptive statement, an omission of required material, or a new circumstance has arisen.<sup>36</sup>

2.36 A contravention of subsection 728(1) of the Corporations Act is a criminal offence by an issuer if the contravention is materially adverse to an investor.<sup>37</sup>

2.37 Section 729 of the Corporations Act currently establishes 'deemed liability', applying liability to all directors of the relevant body, regardless of their involvement, for misleading or deceptive statements and omissions in a disclosure document:

If there is an offer of securities and a person suffers loss or damage because of a misleading or deceptive statement, an omission of required material, or where a new circumstance had arisen in a disclosure a document, the person

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33 *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, p. 9.

34 *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, p. 10.

35 *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, p. 11.

36 *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, p. 20.

37 Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011, p. 20.

has the right to recover compensation for that loss or damage from a range of persons including each director of the body making the offer.<sup>38</sup>

2.38 The Treasury discussion paper noted that the amendments provide specific criteria for simple corporate bonds and therefore, 'it may be appropriate to remove directors' deemed liability for retail corporate bonds'.<sup>39</sup> Treasury has noted that:

Removing directors' deemed liability would be consistent with Council of Australian Governments (COAG) developments, noting that COAG has agreed there is a case for reform to promote a consistent and principled approach to the imposition of personal criminal liability for corporate fault (similar considerations apply to civil liability).<sup>40</sup>

2.39 The bill proposes to limit the liability of directors with regard to the two-part prospectus for simple corporate bonds such that liability for compensation does not automatically include directors unless they are involved in the prohibited actions:

[F]or an offer of simple corporate bonds under the 2-part simple corporate bonds prospectus, the range of persons to which the person has the right to recover compensation for a loss or damage does not include directors or proposed directors of the body making the offer (and, if the body is a wholly owned subsidiary of a body corporate, does not include directors or proposed directors of that body corporate) unless the director or proposed director is involved in, among other things, the misleading or deceptive statement, the omission of required material, or where new circumstances have not been reflected in the disclosure document as required by the Corporations Act.<sup>41</sup>

## **Part 2—Amendments relating to false or misleading statements**

### ***Reasonable steps obligations***

2.40 Part 9.4 of the Corporations Act relates to offences. Section 1308 in Part 9.4 sets out offences relating to 'false or misleading statements' made by a person.<sup>42</sup>

2.41 In a joint media release, the Treasurer, the Hon. Wayne Swan MP, and the Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, stated

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38 *Explanatory Memorandum (EM), Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013*, pp 20–21.

39 Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011, p. 20.

40 Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011, p. 20.

41 *Explanatory Memorandum (EM), Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013*, p. 21.

42 *The Corporations Act 2001*, s. 1308.

that the bill would amend the Corporations Act to 'clarify the defences provided in respect to director's liability that apply to all offers of securities'.<sup>43</sup>

2.42 Part 2 of Schedule 1 of the bill proposes adding 'reasonable steps' defences for directors in Part 9.4 of the Corporations Act. The 'reasonable steps' provisions of the bill are as follows:

- A statement or information was not false or misleading in a material particular:
  - If the person proves that all inquiries (if any) that were reasonable in the circumstances to make were made, and after making those inquiries the person believed on reasonable grounds that the statement or information was not misleading in a material particular. *[schedule 1, items 52 and 53, subsections 1308(10) and 1309(7)]*
  - If the person proves that they relied on information provided to them by somebody other than a director, employee or agent of the body (if the person is a body) or someone other than an employee or agent of the individual (if the person is an individual) and the reliance placed on the information by the person was reasonable in the circumstances. *[schedule 1, items 52 and 53, subsections 1308(12) and 1309(9)]*
- The information in a document did not omit or have omitted from it any matter or thing that without which the document would be misleading or deceptive in a material respect:
  - If the person proves that all inquiries (if any) that were reasonable in the circumstances were made, and after making those inquiries the person believed on reasonable grounds that there was no such omission. *[schedule 1, item 52, subsection 1308(11)]*
  - If the person proves that they relied on information provided to the person by somebody other than a director, employee or agent of the body (if the person is a body), or someone other than an employee or agent of the individual (if the person is an individual), and the reliance placed on the information by the person was reasonable in the circumstances. *[schedule 1, item 52, subsection 1308(13)]*
- The information in the document did not omit or have omitted from it any matter or thing that would render the information in the document misleading in a material particular:
  - If the person has made all inquiries (if any) that were reasonable in the circumstances to make, and after making those inquiries the person believed on reasonable grounds that there was no such omission. *[schedule 1, item 53, subsection 1309(8)]*

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43 The Hon. Wayne Swan MP, Deputy Prime Minister and Treasurer, and the Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, 'Retail corporate bonds legislation', Joint media release, Canberra, 20 March 2013, [http://billshorten.com.au/retail\\_corporate\\_bonds\\_legislation](http://billshorten.com.au/retail_corporate_bonds_legislation) (accessed 7 May 2013).

- If the person proves that they relied on information provided to the person by somebody other than a director, employee or agent of the body (if the person is a body), or someone other than an employee or agent of the individual (if the person is an individual), and the reliance placed on the information by the person was reasonable in the circumstances. *[schedule 1, item 53, subsection 1309(10)]*<sup>44</sup>

## Submitter views on Schedule 1

2.43 The committee received seven submissions addressing Schedule 1 of the bill, with two public submissions and one confidential submission making specific comments. All the submissions supported the general thrust of the amendments to develop the retail corporate bond market.

2.44 The committee heard evidence from Treasury that the retail bond market is currently quite small, with, for example, only 0.7 per cent of self-managed super fund assets being held as debt securities in September 2012.<sup>45</sup>

2.45 Treasury also noted that while Australian investors are active in the equity market, investors could benefit from the development of the retail debt market because it would allow them to diversify their exposure by including lower-risk and less-volatile debt securities, such as bonds, in their portfolios. This was seen as particularly important for retirement-age Australians, particularly with the increase in life expectancy over recent decades.<sup>46</sup>

2.46 Treasury has stated that it expects the initial market for retail simple corporate bonds to comprise older Australians and the trustees of self-managed super funds looking to diversify into relatively low-risk stable assets:

[T]he type of investors who will be attracted to simple corporate bonds are likely to be older Australians and self-managed super fund trustees who are looking to manage longevity risk and looking for long-term, low risk, relatively stable sources of income that will diversify their holdings against equities and other, perhaps more volatile or higher-risk assets in their portfolios.<sup>47</sup>

2.47 Treasury also saw that developing the retail bond market would alter the structure of the market and facilitate bank lending to smaller domestic customers:

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44 *Explanatory Memorandum (EM), Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013*, pp 21–22.

45 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 9; see also SMSF Owners' Alliance, *Submission 13*, p. 1.

46 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 9; see also SMSF Owners' Alliance, *Submission 13*, p. 1.

47 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 13; see also SMSF Owners' Alliance, *Submission 13*, p. 1.

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Growing the retail bond market will help to reduce reliance on offshore wholesale funding markets for raising corporate debt and free-up bank balances for lending to the domestic market, particularly small businesses.<sup>48</sup>

2.48 Similarly, industry foresaw benefits to corporate entities, investors and businesses:

A deeper and more liquid retail corporate bond market has benefits for corporates, businesses and investors. For corporates, it will broaden their funding sources and help facilitate their growth aspirations. For investors, a fully functioning retail corporate bond market will offer investors more choice and an opportunity to diversify their investments. Facilitating this funding will free up the banks' balance sheets to continue supporting SMEs, who traditionally do not have the same access level of access to capital markets as their larger counterparts.<sup>49</sup>

2.49 The committee received evidence about the possible reasons why the retail market in corporate debt in Australia was underdeveloped. Mr Steve Lambert, Executive General Manager of Debt Markets at National Australia Bank (NAB), agreed with the committee that there are fewer debt issues and fewer debt instruments available compared to the number of equities in the market, and that as a retail investor, it is more difficult to purchase small amounts of debt (for example, \$A1000–2000) than it is to purchase the equivalent amount of shares.<sup>50</sup>

2.50 However, Mr Lambert also pointed to the complexity of prospectus requirements and director liability as other key impediments to developing the retail corporate bond market, and as reasons why so far, only one entity has taken advantage of ASIC Class Order 10/321 to issue 'vanilla' corporate bonds.<sup>51</sup>

### ***Prospectus requirements***

2.51 The submissions that commented specifically on Schedule 1 all supported the amendments regarding the proposed two-part prospectus insofar as it aims to make the documentation process for issuing corporate bonds no more onerous than the process for issuing equities. However, some submitters made comments regarding various aspects of the proposed two-part prospectus. Of particular note were suggestions for the use of term sheets for simple corporate bonds, and the use of a two-part prospectus for more complex corporate bonds.

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48 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 9.

49 Mr Steve Lambert, Executive General Manager, Debt Markets, National Australia Bank, *Committee Hansard*, 22 April 2013, p 1.

50 See the exchange between Mr Paul Fletcher MP and Mr Steve Lambert, Executive General Manager, Debt Markets, National Australia Bank, *Committee Hansard*, 22 April 2013, pp 4–5.

51 Mr Steve Lambert, Executive General Manager, Debt Markets, National Australia Bank, *Committee Hansard*, 22 April 2013, pp 2 and 5.

*Use of term sheets for simple corporate bond offers*

2.52 The bill proposes a two-part prospectus comprising a base disclosure document and offer document for the issue of simple corporate bonds.

2.53 However, some submitters noted that while a base disclosure document and offer document are appropriate for 'corporate bonds with more unusual or complex features', a base document and a two-page term sheet should be sufficient for those bonds which meet the criteria of a simple corporate bond:

For Simple Corporate Bonds which meet the criteria stated in the legislation, we propose a base disclosure document which allows information to be incorporated by reference from ASIC, as well as a two-page term sheet outlining the key characteristics of the bond, rather than an offer document.<sup>52</sup>

2.54 Mr Lambert explained how the base document and term sheet currently operate in the wholesale market:

Typically in the wholesale market a large issuer will have an offering circular or an offering document which would have all of the base details upon which that series of bonds could be issued under. It has all of the details; it has everything that they will need. You need both documents; you need to have reference to that. And then every time you do another issue or another transaction, that is done under an offering circle or a term sheet, which is basically a couple of pages and which has all of the details of that specific issue. You need [to] read both together. Rather than every time you do a new deal doing quite a fat document—you have already done the fat one once—you just do a skinny one for every subsequent issue. That is probably the best way to think about it.<sup>53</sup>

2.55 NAB provided the committee with recommendations that it made in its submission to the Treasury discussion paper on retail corporate bonds regarding the information that should be included in a term sheet and a two-part prospectus.<sup>54</sup>

*Use of a two-part prospectus for more complex corporate bonds*

2.56 Mr Lambert also expressed a preference for more complex offers that do not meet the criteria for an offer of simple corporate bonds (for example, a bond issue with a life of greater than 10 years) to still be eligible for a two-part prospectus that would consist of a base document and an offer document (as opposed to a two-page

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52 National Australia Bank, *Submission 6*, [pp 2–3]; see also Australian Bankers' Association, *Submission 14*, p. 3.

53 Mr Steve Lambert, Executive General Manager, Debt Markets, National Australia Bank, *Committee Hansard*, 22 April 2013, p. 3.

54 National Australia Bank, *Submission 6*, NAB response to Australian Government discussion paper February 2012, Appendices 1 and 3.

term sheet). Being eligible for a two-part prospectus would obviate the need for a corporate entity to prepare a full prospectus with every subsequent bond issue and would therefore make it easier for corporate issuers to meet the legislative requirements.<sup>55</sup>

2.57 In a prior response to a Treasury discussion paper<sup>56</sup> that canvassed various options that would allow more complex bonds to be included under a simplified two-part prospectus regime, NAB proposed that terms longer than 10 years should be permitted under a two-part prospectus 'provided there is clear and adequate disclosure'.<sup>57</sup>

2.58 NAB also suggested that subordinated corporate bonds should be permitted, but only with a two-part prospectus that 'clearly outlines the capital structure and the ranking of the bonds within that structure'.<sup>58</sup> Mr Lambert confirmed that NAB is comfortable with the fact that the bill does not allow subordinated bonds to qualify as simple corporate bonds.<sup>59</sup>

2.59 However, NAB would not recommend allowing deferral of interest because 'it is inconsistent with the view that corporate bonds provide a regular and stable income stream', unless it was restricted to hybrid issues and clearly disclosed.<sup>60</sup>

2.60 NAB pointed out that investor confusion about the nature of the bond issue should be reduced by having the distinction between a two-page term sheet for simple corporate bonds and a more detailed offer document (of between 10 and 20 pages) for more complex corporate bonds.<sup>61</sup>

#### *Contents and length of the offer document*

2.61 An offer document would contain 'key details of the transaction as well as any matters material to consideration of the investment which has not been the subject of

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55 Mr Steve Lambert, Executive General Manager, Debt Markets, National Australia Bank, *Committee Hansard*, 22 April 2013, p. 3.

56 Treasury, *Discussion paper: Development of the retail corporate bond market: Streamlining disclosure and liability requirements*, December 2011.

57 National Australia Bank, *Submission 6*, NAB response to Australian Government discussion paper February 2012, [p. 6].

58 National Australia Bank, *Submission 6*, NAB response to Australian Government discussion paper February 2012, [p. 6].

59 See the exchange between Mr Paul Fletcher MP and Mr Steve Lambert, Executive General Manager, Debt Markets, National Australia Bank, *Committee Hansard*, 22 April 2013, p. 5.

60 National Australia Bank, *Submission 6*, NAB response to Australian Government discussion paper February 2012, [p. 7].

61 National Australia Bank, *Submission 6*, [p. 3].

continuous disclosure'.<sup>62</sup> However, Mr Lambert pointed to the importance of restricting the offer document to a reasonable length (between 10 and 20 pages) in order that it would actually be read carefully by potential investors and that practical disclosure of key elements could occur.<sup>63</sup>

2.62 In noting that the content requirements for the disclosure documents associated with simple corporate bonds have not yet been released, and given that as at 22 April 2013 only one entity had taken advantage of ASIC Class Order 10/321 relating to the issue of 'vanilla' corporate bonds, the Australian Bankers' Association (ABA) requested that the government consult with industry over the specific content requirements for the new disclosure regime.<sup>64</sup>

2.63 Treasury confirmed that the disclosure regime for simple corporate bonds will be more streamlined than the regime under ASIC Class Order 10/321 relating to 'vanilla' corporate bonds, and that consultation with industry is occurring:

Treasury is currently engaging in targeted consultation with key stakeholders to develop content requirements for the disclosure documents that will strike an appropriate balance between streamlining disclosure for issuers, and ensuring that the documents are comprehensible and effective to retail investors. Treasury will publicly consult on the draft regulations to ensure the content requirements achieve these goals.<sup>65</sup>

2.64 Treasury expects to release the draft regulations by July 2013.<sup>66</sup>

#### *Life of the base document*

2.65 The ABA and NAB proposed a five-year life for the base document in order to facilitate more repeat issuances, rather than the three-year life proposed in the legislation.<sup>67</sup> NAB stated that this finding was 'based on direct feedback we have received from potential issuers of Simple Corporate Bonds from corporate Australia'.<sup>68</sup>

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62 National Australia Bank, *Submission 6*, [p. 3].

63 Mr Steve Lambert, Executive General Manager, Debt Markets, National Australia Bank, *Committee Hansard*, 22 April 2013, p. 3.

64 Australian Bankers' Association, *Submission 14*, pp 3–4.

65 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

66 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 9.

67 Australian Bankers' Association, *Submission 14*, p. 3; National Australia Bank, *Submission 6*, [p. 3].

68 National Australia Bank, *Submission 6*, [p. 3].

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*Eligibility criteria for simple corporate bonds—ranking, tenor, maximum price, minimum scale requirements, and mandatory two-part prospectus*

2.66 There was support from the ABA and NAB for the provision that simple corporate bonds cannot be subordinated to any other unsecured creditors, effectively meaning that simple corporate bonds 'rank at least equally with all other unsubordinated and unsecured debt obligations of the issuer'.<sup>69</sup> The ABA notes this provision is consistent with the provisions for 'vanilla' corporate bonds in ASIC Class Order 10/321 and is 'in line with the established Australian wholesale bond market'.<sup>70</sup>

2.67 The ABA was critical of the proposal to limit the life of simple corporate bonds to 10 years.<sup>71</sup> NAB felt that while a bond issue with a tenor greater than 10 years would not qualify as a simple corporate bond, it should still be eligible to qualify for disclosure under a two-part prospectus regime.<sup>72</sup>

2.68 Noting that ASIC Class Order 10/321 relating to 'vanilla' corporate bonds does not prescribe a maximum price for simple corporate bonds, the ABA also regarded the inclusion of the \$A1000 maximum bond price in the bill as 'unnecessary and problematic'.<sup>73</sup>

2.69 Although NAB did not express a strong view on the maximum bond price for simple corporate bonds, Mr Lambert noted that a maximum bond price of \$A1000 could stimulate the market by giving retail investors greater choice and allow investors to more easily diversify their portfolio and thereby reduce risk.<sup>74</sup>

2.70 NAB welcomed the clarification that the \$A50 million minimum subscription for an offer-specific prospectus only relates to the initial bond issue, and not to subsequent issues.<sup>75</sup>

2.71 Treasury noted that the value of having a minimum scale requirement of \$A50 million was that it would effectively limit bond issuances under the simple corporate bonds regime to the top 200 companies in Australia and would therefore

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69 Australian Bankers' Association, *Submission 14*, p. 2; see also the exchange between Mr Paul Fletcher MP and Mr Steve Lambert, Executive General Manager, Debt Markets, National Australia Bank, *Committee Hansard*, 22 April 2013, p. 5.

70 Australian Bankers' Association, *Submission 14*, p. 2.

71 Australian Bankers' Association, *Submission 14*, p. 2.

72 See the earlier section in this chapter titled 'Use of a two-part prospectus for more complex corporate bonds', and National Australia Bank, *Submission 6*, [pp 2–3].

73 Australian Bankers' Association, *Submission 14*, p. 2.

74 Mr Steve Lambert, Executive General Manager, Debt Markets, National Australia Bank, *Committee Hansard*, 22 April 2013, pp 5–6.

75 National Australia Bank, *Submission 6*, [p. 2].

'ensure that the retail corporate bonds that are issued under this regime are high quality'.<sup>76</sup>

2.72 Following questions from the committee, Treasury stated that the two-part prospectus for simple corporate bonds was a mandatory requirement because allowing both single and two-part prospectuses could create confusion, whereas ensuring a consistent standard in the market would build investor confidence. Furthermore, Treasury wanted to set a market standard where investors would get used to looking for and reading both parts of a prospectus:

One of the challenges with the two-part prospectus is that we want people who receive the issue specific, the second part of the prospectus, to also look at the base. Because it is not a summary of the base; it is the key information about the issuance, about that tranche. So it is important that retail investors receive both documents and see both documents as being the disclosure in combination.<sup>77</sup>

### *Continuous disclosure*

2.73 The ABA requested more clarity on how the continuous disclosure regime for listed entities would interact with the new regime for simple corporate bonds. The ABA also submitted that documents issued under the continuous disclosure regime that are subsequently incorporated by reference in a disclosure document 'should not be captured by the prospectus liability regime'.<sup>78</sup>

### *Liability regime*

2.74 The committee received only one submission—from the ABA—that made specific comments on the proposed changes to directors' civil liability and the reasonable steps obligations.

2.75 The ABA argued that modelling retail disclosure processes and documents on the wholesale market would remove the onus of liability for ensuring accurate disclosure from directors and locate it with management, thereby reducing the costs associated with issuing retail corporate bonds:

This would enable processes and documentation adopted by the wholesale market to be used and create greater consistency between liability regimes by allowing due diligence to be dealt with at a management rather than

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76 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 13.

77 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 13.

78 Australian Bankers' Association, *Submission 14*, p. 4.

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board level, thereby reducing the costs with debt capital raisings in the retail market.<sup>79</sup>

2.76 The ABA supported the proposal to reduce the liability standard on directors in respect to retail corporate bonds offered under a two-part prospectus, but drew attention to the possibility that, in practice, both civil and criminal liability may still apply to directors:

The ABA supports the Government's proposal to reduce the liability standard on directors in respect to retail corporate bonds by removing strict liability for directors named in (a defective) two-part prospectus as a proposed director under section 729 of the *Corporations Act 2001*. As a result directors will only have civil liability for a defective two-part prospectus if personally 'involved' in the defective statements. 'Involvement' of directors in a prospectus is inferred from the continued requirement for all of the directors of an issuing company to consent to the issue of a two-part prospectus. Directors, therefore, also remain criminally liable under sections 1308 and 1309 of the *Corporations Act 2001* if a prospectus is false or misleading unless a director can prove they have made reasonable enquiries, and after doing so, believed on reasonable grounds that the prospectus was not defective (due diligence defence) or placed reasonable reliance on information provided by other people (reasonable reliance defence).<sup>80</sup>

2.77 Given that the ABA does not believe the bill has addressed the need for a director to be personally involved in the due diligence process, the ABA argues that despite the amendments in the bill, there would still be 'a greater legal risk, administrative complexity and more costly burden involved in issuing retail corporate bonds than wholesale corporate bonds'. Consequently, the ABA maintains that the regulatory bias that causes an entity to favour bond issues into the wholesale market has not been dealt with by the bill.

#### *Treasury response*

2.78 The committee received evidence from Treasury that removing directors' deemed civil liability for a two-part prospectus for simple corporate bonds does in fact remove the need for directors to carry out due diligence on that issue:

Under the existing law of the Corporations Act directors can generally be sued for damages for prospectuses which contravene the prohibition against misleading or deceptive statements or omissions, even if they are not involved in the particular contravention. The bill relieves their liability unless they are actively involved in the contravention, so directors cease to have deemed civil liability. They continue to have involvement of a civil liability but the due diligence defences remain available.

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79 Australian Bankers' Association, *Submission 14*, p. 3, fn. 3.

80 Australian Bankers' Association, *Submission 14*, p. 4.

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It means that they do not have to conduct due diligence for all of the processes in developing the prospectus. It will reduce and relieve some of the compliance burden in developing prospectuses because they no longer have deemed liability for any contraventions in the prospectus unless they were personally involved or knew of the contraventions.<sup>81</sup>

2.79 Dr Sandlant explained what involvement-based civil liability for directors entailed:

If they know of or were involved in approving information in the prospectus which is a contravention of the requirements in the Corporations Act against misleading and deceptive statements or omissions, then they still have liability for that involvement. But they do not have liability on reasonable grounds for omissions or misstatements which might have been made in the prospectus development process by officers who are working in their business.<sup>82</sup>

2.80 These points were reiterated by Treasury in a written response to the committee, along with an explanation of what would constitute evidence for involvement in material misstatement or omission:

Directors will no longer be subject to the deemed civil liability for offers of simple corporate bonds. As such, directors will not be 'deemed' liable for a contravention in respect to misstatements in, or omissions from, disclosure documents provided for simple corporate bond offers. However, any person 'involved' in a contravention will continue to face liability for that contravention.

The amendments in the Corporations Amendments (Simple Corporate Bonds and Other Measures) Bill 2013 (the Bill) provide that a director will be liable for a misstatement in, or omission from, a disclosure document if they are 'involved' in the misstatement or omission. In addition, directors will continue to be liable if they become aware of a misstatement or omission and fail to bring it to the attention of the person making the offer.

Involved (as defined in section 79 of the Corporations Act) means that the person has:

- aided, abetted, counselled or procured a contravention; or
- induced a contravention; or
- been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to a contravention; or
- conspired with others to effect a contravention.

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81 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 10.

82 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 10.

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Relevant evidence to establish this contravention will be evidence which, if it were accepted, could rationally affect (directly or indirectly) the assessment of the probability of a fact which establishes whether a director was involved in a misstatement or omission, consistent with what constitutes relevant evidence under general law.<sup>83</sup>

2.81 Dr Sandlant also noted that directors would incur criminal liability if 'they have broken any relevant laws in relation to their duties as directors, other relevant laws as well as the civil liability'.<sup>84</sup>

2.82 In response to committee concerns about the safety of a product that did not incur deemed civil liability on the part of directors, Dr Sandlant observed that director liability had not been completely removed, and that simple corporate bonds were, by definition, a low-risk product:

There are two points to make. One is that directors still have involvement based civil liability and criminal liability. So liability has not been completely removed, it has just been made, I guess, more rational or a rebalancing of the due diligence process to make it more cost effective for, and to encourage issuance of, corporate bonds. That is one factor—the liability has not been removed completely, it has just been streamlined, if you like. The other factor is that because the bill requires simple corporate bonds to be, as we were discussing just a moment ago, relatively simple and low risk that gives investors a greater degree of confidence in the product.<sup>85</sup>

2.83 Consequently, Dr Sandlant identified the compromise at the heart of the bill; namely, that applying restrictive qualifying criteria to simple corporate bonds allowed the relaxation of some of the 'arguably onerous requirements of prospectus disclosure and directors' liability'.<sup>86</sup>

2.84 In reiterating the rationale for the changes, Treasury confirmed for the committee that the liability provisions in the Corporations Act have only been eased for simple corporate bonds and not for other securities:

Market participants have indicated that the liability provisions in the Corporations Act are hindering the offer of corporate bonds to retail investors in Australia. The deemed liability placed on directors when an offer of corporate bonds is made to retail investors requires a level of director engagement in the due diligence process that is onerous.

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83 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

84 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 10.

85 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 10.

86 Dr Richard Sandlant, Manager, Disclosure and International Unit, Treasury, *Committee Hansard*, 22 April 2013, p. 10.

However, while the development of a deep and liquid corporate bond market is a widely supported policy goal, it is also important that consumers continue to receive adequate regulatory protection. For this reason, the liabilities for directors have been eased only for simple corporate bonds.

Simple corporate bonds are relatively safe securities, as they must satisfy the conditions set out in the Bill. These conditions restrict the type of bonds that can be classified as simple corporate bonds to senior debt that is issued by high quality corporate entities (most likely the top 100 to 200 companies).<sup>87</sup>

2.85 Treasury also emphasised that the easing of director liability in section 728 was contingent on the criteria for simple corporate bonds as set out in proposed section 713A remaining the same. Treasury indicated that should the criteria in section 713A be made more flexible, the issue of directors' deemed liability would likely be revisited:

Section 713A sets out the conditions for offering a simple corporate bond, and the definition of a simple corporate bond. For the amendments in section 728 to apply, the offer must be in relation to simple corporate bonds, so section 713A must be satisfied.

If the criteria in section 713A are made more flexible, this would increase the level of risk associated with the bonds. In the event such changes were contemplated, it is likely that further review and consultation on directors' deemed liability would be undertaken.<sup>88</sup>

2.86 The SMSF Owners' Alliance supported the position adopted by Treasury and stated that it believed the conditions set out in the bill would 'provide sufficient protection for SMSFs' and that they could be complemented by the regulations under development.<sup>89</sup>

2.87 The committee questioned Treasury about whether the changes to director liability created an inconsistency and how the amendments would fit in with the Council of Australian Governments' (COAG) moves to harmonise director liabilities across jurisdictions.<sup>90</sup> Treasury responded that:

The COAG harmonisation of director liability is aimed at making director liability comply with a specific set of agreed-upon principles (the COAG Principles). These principles include the removal of deemed liability of directors for corporate fault where it is not appropriate, and that where derivative liability is imposed, it should be imposed in accordance with principles of good corporate governance. The reforms in the Bill are not

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87 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

88 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

89 SMSF Owners' Alliance, *Submission 13*, p. 1.

90 Ms Deborah O'Neill MP, Chair, *Committee Hansard*, 22 April 2013, p. 11.

directly in the scope of the type of director liabilities that COAG are considering, however, the proposed changes are consistent with the COAG principles.<sup>91</sup>

### *Reasonable steps*

2.88 In a joint media release, the Treasurer and the Minister for Superannuation and Financial Services stated that the clarification of the reasonable steps defences applied 'to all offers of securities'.<sup>92</sup>

2.89 Yet in his Second Reading Speech, Minister Shorten stated that the bill 'provides clarification around the due diligence defence in respect to directors' criminal liability in offering corporate bonds'.<sup>93</sup>

2.90 The committee asked for clarification on whether the reasonable steps in sections 1308 and 1309 would apply to all corporate bonds and securities.<sup>94</sup> Treasury confirmed that they would, and that the amendments would apply across the entire Corporations Act:

The proposed amendments that clarify what is meant by 'reasonable steps' in sections 1308 and 1309, apply across the entire Corporations Act.<sup>95</sup>

2.91 Given this, the committee is concerned that the EM does not contain a clear explanation for the amendments to the 'reasonable steps'. Schedule 1 of the bill pertains to simple corporate bonds, and yet the amendments to the reasonable steps provisions were added to the end of Schedule 1 without any context or clear reasoning being given.

2.92 Treasury responded that because the reasonable steps were a clarification, a comprehensive explanation was not required:

Paragraph 1.17 [of the EM] states 'The amendments in the Bill to the directors' liabilities have been designed to reduce the burden on directors when issuing corporate bonds to retail investors under the 2 part prospectus regime and will provide directors with greater clarity on the steps required

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91 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

92 See the Hon. Wayne Swan MP, Deputy Prime Minister and Treasurer, and the Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, 'Retail corporate bonds legislation', Joint media release, Canberra, 20 March 2013, [http://billshorten.com.au/retail\\_corporate\\_bonds\\_legislation](http://billshorten.com.au/retail_corporate_bonds_legislation) (accessed 10 April 2013).

93 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, *Second Reading Speech*, House of Representatives, 20 March 2013.

94 See Mr Paul Fletcher MP, *Committee Hansard*, 22 April 2013, p. 11.

95 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

as part of the due diligence process in relation to certain criminal liability offences'.

As the proposed changes to the operation of sections 1308 and 1309 of the Corporations Act merely clarify what 'reasonable steps' mean, additional commentary to that provided in paragraph 1.17 was not required.<sup>96</sup>

2.93 In response to questions from the committee, Treasury provided an explanation for these changes:

While the current law provides a defence of 'reasonable steps' to the offences in sections 1308 and 1309, it does not provide guidance on what constitutes 'reasonable steps'. The purpose of the amendment is to provide greater clarity as to what 'reasonable steps' means.

The amendments provide that a person should be deemed to have taken 'reasonable steps' if they make reasonable inquiries or place reasonable reliance on information provided by others. The proposed amendments reflect the practical application of the criminal liability provisions in the Corporations Act and are consistent with stakeholder views.<sup>97</sup>

2.94 Treasury also confirmed that the clarification of reasonable steps was not predicated on removing the deemed civil liability for directors in the issuance of simple corporate bonds, but instead 'merely provide[d] increased guidance on the application of the defences for criminal liability for deceptive and misleading statements'.<sup>98</sup>

2.95 Questioned by the committee on the consultation process undertaken with regard to the reasonable steps, Treasury gave the following details:

Treasury has had extensive public and targeted consultation on the Bill and the measures within the Bill (including the clarification of the meaning of 'reasonable steps' in sections 1308 and 1309 of the Corporations Act) since 2011. Below is a summary of that consultation:

- On 13 December 2011 the discussion paper 'Development of the retail corporate bond market: streamlining disclosure and liability requirements' was released for public consultation. Submissions on the discussion paper closed on Friday 10 February 2012.
- On 24 January 2012, Treasury held a roundtable meeting in Sydney with over 30 market participants including the G100 and the Australian Shareholders Association to discuss aspects of the December 2011 discussion paper.
- Throughout 2012 and 2013, a number of small targeted consultations (comprising between 2-10 attendees) were held with various market participants.

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96 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

97 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

98 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

- On 11 January 2013, exposure draft legislation was released for public consultation. Submissions on the exposure draft legislation closed on Friday 15 February 2013.

A representative from the Australian Shareholders Association attended the 24 January 2012 roundtable. At the roundtable, a comprehensive discussion took place on the issue of the proposed removal of directors' civil liability and the proposed clarification to what is meant by 'reasonable steps'.<sup>99</sup>

### ***Parallel trading***

2.96 NAB welcomed the development of depositary interests that would allow the parallel trading of simple corporate bonds in the wholesale and retail markets.<sup>100</sup>

2.97 The committee questioned Treasury firstly about how the liability provisions apply to bonds that are traded, and secondly, whether the liability provisions associated with the bond transferred to the owner of the depositary interests, and whether every subsequent person who acquires the bonds when they are traded has the benefit of them.<sup>101</sup>

2.98 Treasury responded that:

Under the current law, liability for misstatements etc. attaches to securities in two ways:

- when an offer of corporate bonds is made by the issuer to retail investors, through the application of the liability provisions in section 728; and
- through the general liability provisions in section 1041H, which apply when trading occurs on the secondary market.

The application of the liability provisions for an offer of simple corporate bonds as well as for secondary trading will be consistent with the current law (as outlined above).

As outlined above, and consistent with current law, it is only the person who initially acquires the simple corporate bonds from the issuer who benefits from the liability provisions in section 728. However, every subsequent person who acquires them through secondary trading (including the secondary trading of simple corporate bond depositary interests) will have the benefit of the general liability provisions in section 1041H.<sup>102</sup>

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99 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

100 National Australia Bank, *Submission 6*, [p. 2].

101 Mr Paul Fletcher MP, *Committee Hansard*, 22 April 2013, p. 12.

102 Treasury, answer to question on notice, 22 April 2013 (received 8 May 2013).

### ***Investor education***

2.99 NAB emphasised that a key element in developing the retail corporate bond market was the education of retail investors. As part of its efforts to educate investors, NAB has 'commissioned the Australian Centre for Financial Studies (ACFS) to develop a series of reports about the corporate bond market in Australia'.<sup>103</sup>

### ***Adviser education and research***

2.100 The Stockbrokers Association drew attention to the 'fundamental differences between equity and debt securities' and cautioned that some 'stockbrokers with little experience in bonds may not be equipped to advise on these products'. The Stockbrokers Association stated that adviser knowledge would 'definitely need to be updated if more bonds are to be presented as investment options to retail clients'.<sup>104</sup>

2.101 The Stockbrokers Association also observed that compared with equities, there is little reliable research pertaining to the bond market with which to advise retail clients:

Another issue in adding bonds (including CGS) to the suite of stockbrokers' offerings is the lack of dependable research. With shares, stockbroking firms rely on in-house expertise from specialist research analysts to analyse the relevant issuer companies and sectors, or have third party arrangements with specialist research houses to obtain such research. This research informs the advice that is then given to clients. Accordingly, retail advisers may lack specialist research in order to properly advise their clients.<sup>105</sup>

### ***Clarification of specific elements in the bill***

2.102 In its submission, NAB sought clarity on specific elements in the bill. The committee sent these as questions on notice to Treasury and the responses from Treasury are given here.

2.103 NAB asked Treasury about how 'among other things' in section 1.67 of the EM will be defined, as well as whether subsection 713A(8) is restricted to the Bank Bill Swap rate (BBSW) or whether issuers will be allowed to reference a range of indices. Treasury responded that:

In section 1.67, the reference to 'among other things' is intended to be inclusive. It is not defined in the legislation. When creating a prospectus, there [are] a number of provisions of the Corporations Act where a director may be 'involved in' a contravention and face accessorial liability.

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103 National Australia Bank, *Submission 6*, [p. 1].

104 Stockbrokers Association of Australia, *Submission 2*, p. 2.

105 Stockbrokers Association of Australia, *Submission 2*, p. 3.

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Section 713A(8) does not refer to the BBSW, or any other specific index. Under the current law, issuers may reference 'a floating rate that is comprised of a reference rate and a fixed margin'.<sup>106</sup>

2.104 NAB asked about the consequences if, subsequent to issuance, the issuer is removed from listed status on an appropriate exchange. Treasury replied that:

Treasury understands that the consequences of a company delisting will be provided for in the individual bond instruments. Treasury has not mandated that a particular consequence flows from delisting because this may affect commercial outcomes. For example, if a company is taken over and subsequently delists, the bidding company may wish to honour the debt obligations of the target company.<sup>107</sup>

2.105 In regards to section 1.26 which states that a 'regulation making power has been inserted into Chapter 2L so that the requirement for a trust deed and trustee is able to be removed for the making of the specified offer of debentures or a specified class of offers of debentures'.<sup>108</sup> NAB sought clarification as to how this would intersect with ASIC's recent consultation paper 199, which proposes reforms to the regulation of the debenture sector, including increasing the role of trustees for issues of simple corporate bonds. Treasury answered that:

ASIC's discussion paper was released prior to public industry consultation on this point earlier this year. Consultation revealed that there are a number of existing issues with trustees, so a regulation making power was inserted which would allow regulations to be made in future if required. Treasury has not formed a final view on this issue.<sup>109</sup>

### ***Committee views***

2.106 The committee notes that ASIC Class Order 10/321 has not been successful in increasing the issue of 'vanilla' or simple corporate bonds. It supports the process through which Treasury and industry stakeholders have worked to develop regulations that strike an appropriate balance between streamlining the issuing process and maintaining appropriate investor safeguards. The committee is keen to understand whether the issue of an offer document (as opposed to, for example, a two-page term sheet) is viewed as a significant barrier to corporate entities engaging in the retail market, or whether the removal of the due diligence requirements for directors is sufficient to encourage greater supply into the retail simple corporate bond market.

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106 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

107 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

108 *Explanatory Memorandum (EM)*, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, [schedule 1, item 8, section 283AA], p. 10.

109 Treasury, answer to question on notice, 22 April 2013 (received 2 May 2013).

2.107 The committee notes that the bill proposes measures that seek to streamline the regulatory burden faced by directors in issuing simple corporate bonds. It believes that the two-part prospectus, the ability to trade simple corporate bonds using simple retail corporate bond depositary interests, and the removal of deemed civil liability for misleading and deceptive statements in a disclosure document will all encourage the development of a deeper market for these securities. However, the challenge of developing this market will not be realised by focusing solely on supply-side factors. Crucially, there must be demand for these products among retail investors. Generating this demand will rely on educating retail investors as to the features of simple corporate bonds and offering a product that genuinely meets the needs and risk profile of investors.

2.108 Related to the above point, the committee also notes that the attractiveness of simple corporate bonds relative to other types of retail investment, including direct investment in property, may also depend on the relative tax treatment of the various types of investment.

2.109 The committee found the EM to be obscure and ambiguous on certain points, in particular with respect to the 'reasonable steps' obligations. The answers to questions on notice provided useful clarification, but the committee suggests that the quality of the EM could be improved.

### **Recommendation 1**

**2.110 The committee recommends that Treasury amend the EM to more accurately reflect that the clarification of 'reasonable steps' applies across the entire Corporations Act to all offers of securities.**