

**Senate Standing Committee on Economics**

**ANSWERS TO QUESTIONS ON NOTICE**

**Treasury Portfolio**

Budget Estimates

4 – 6 June 2013

**Question: BET 116-118**

**Topic: Debenture Issuing Companies**

**Written: 13 June 2013**

**Senator WILLIAMS asked:**

116. ASIC proposes through CP199 that debenture-issuing companies be required to hold a risk-weighted 8% capital equity where the risk weighting proposed is morphed from an APRA requirement of ADIs. What has caused ASIC to arrive at this capital requirement after the Banksia collapse when ASIC knows that (a) mismanagement of defaulting loans is the cause of the problem and (b) that well-run debenture issuing companies should require no capital or little capital.
- What is in it for debenture-issuing companies if they comply with this high level of capital requirement?
117. Why do secured note issuers have to say in advertising that investors are at risk of “losing some or all of their principal and interest” when it is NOT possible to lose all their capital?
118. Are the ASIC CP199 proposed changes to be implemented by class orders or legislation in relation to capital and liquidity requirements and what is ASIC’s time frame for its implementation?

**Answer:**

116. **What is in it for debenture-issuing companies?**

Under our proposals only debenture issuing companies that comply with the proposed capital requirement of 8%, and meet other requirements, will be able to continue operating their business by accepting investments from retail investors. The proposal is to put such entities on a more sustainable footing. However, our proposed capital requirements should not be taken as a basis for assuming that retail debenture issuing lenders will not fail in the future.

**What has caused ASIC to arrive at this capital requirement?**

ASIC arrived at the 8% capital requirement having regard to a number of factors. This included analysis of: similar requirements applying to APRA regulated deposit takers but that are not currently applicable to debenture-issuing companies; the 8% equity capital disclosure benchmark in ASIC Regulatory Guide 69 that has been in place since early 2008; the regulation applicable to similar entities in New Zealand; and extensive consultation with market experts and industry groups.

We have received strong support for the proposed capital requirements during our public consultation on this issue from a broad range of parties who made submissions under CP199.

Based on our regulatory experience, we do not agree that well-run debenture issuing companies should require no capital or little capital. We also consider that the

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mismanagement of defaulting loans is only one problem of many issues relevant to this sector. We have expressly stated in CP199 that insufficient capitalisation continues to be a contributing factor to failures experienced in the sector. In the case of Banksia, the Receivers and Managers (McGrath Nicol) noted in their report on 7 December 2012 that a key factor in the collapse was Banksia's "...very low equity levels, leading to solvency concerns following even minor losses on the loan portfolio."

ASIC is concerned that many retail debenture issuing lenders have not had sufficient focus on the capital requirements for their business. For this reason, we proposed that retail debenture issuing lenders be required to comply with a mandatory 8% minimum capital ratio.

117. Secured note issuers must include a statement in their advertising that there is a risk that investors could lose some or all of their money. This is required under ASIC Class Order 12/1482 'When debentures can be called secured notes'. ASIC introduced this class order following public consultation where a range of submissions supported the inclusion of risk warnings for these products. The background to this class order is discussed in ASIC media release 12-18MR 'ASIC warns about secured debt products'.

ASIC considers there is a risk investors could lose all of their money, although it is probably more likely that investors in secured notes may only lose some of their money depending on the circumstances. The intention of the risk warning is to assist investors by making them aware of the worst case risk; even if the risk of losing all of their money is not as high as only losing some of it.

118. A final decision on the most appropriate future regulatory framework for the industry has not been determined. We have written to Treasury about the results of the consultation on proposed regulatory reform. We have also spoken to Treasury in relation to the proposals. The way in which any proposed changes resulting from the CP199 consultation are implemented (e.g. by ASIC class order or by legislation) still needs to be determined. The method of any implementation will also impact on the timing of any changes that ASIC may need to make.