PROPERTY COUNCIL of Australia

Property Council of Australia
ABN 13 00847 4422

Level 1, 11 Barrack Street
Sydney NSW 2000

T. +61 2 9033 1900
E. info@propertycouncil.com.au

propertycouncil.com.au
@propertycouncil

Mr Jason Falinski MP
Chair
Standing Committee on Tax and Revenue
PO Box 6021
Parliament House
CANBERRA ACT 2600

28 May 2020

Dear Mr Falinski

Parliamentary inquiry into the development of a corporate bond market in Australia.

The Property Council would like to thank the committee for the opportunity to comment on the development of a corporate bond market in Australia.

The Property Council champions the industry that employs 1.4 million Australians and shapes the future of our communities and cities. Property Council members invest in, design, build and manage places that matter to Australians.

Property is a capital-intensive asset class, requiring significant equity and debt capital to develop and maintain. For our cities and towns to continue to thrive requires diverse and competitive forms of capital, especially now as the economic cycle faces a downturn. At the same time, retail and institutional investors benefit from having diverse and competitive investment choices, with different risk/return profiles to suit their circumstances.

The Property Council supports moves to develop a retail bond market in Australia. A well-developed bond market in Australia would:

- Provide Australian investors with more diversity in the types of investment products available – retail investors are generally limited to term deposits for fixed interest returns or Australian equities which provides a different risk/return profile.
- Provide Australian businesses greater access to diverse and competitively priced funding – market participants have generally had to rely on domestic bank loans and credit providers to fund their operations or utilise offshore bond markets for greater diversity and longer tenor debt.
- Help to securitise Australia's banking sector – which are also heavily reliant on offshore funding markets currently.

We have seen during the Covid-19 pandemic that those markets that have deep retail debt markets were able to respond to the economic shockwaves by continuing to issue bonds while Australia's wholesale bond market froze for corporate issuers. Australia would be better placed to navigate out of the current economic downturn if Australian businesses and investors are able to tap into a deep retail bond market.

Our submission below sets out the main roadblocks and necessary solutions to develop a robust bond market in Australia – in particular, increasing investor awareness of the role corporate bonds can play in a diversified investment portfolio, and reducing regulatory red tape and cumbersome approval processes to make it more efficient for businesses to issue retail bonds into the market.

Increasing investor awareness

Australia will require a substantive and robust retail bond market as the Australian population ages.

Currently Australian's investment choices are limited to:

- Equities – higher returns, but significant capital value risk and income risk as shown recently with companies reducing or suspending dividends
- Term Deposits – safe and very limited capital risk, but lower returns
- Investments in debt/mortgage funds who then invest into debt like instruments or other asset classes with no direct control by the retail investor.

As Australia's working population moves into retirement the requirement to draw down from savings should change the way in which money is invested, from its current form of equity (which is a growth asset) to more fixed income products (which are generally viewed as defensive assets) that provides lower risk and more stable returns.

The challenge

ASIC's 'moneysmart' website provides a great overview of the types of considerations that retail investors should consider when planning and investing for their future. This includes information on setting appropriate financial goals, highlighting the risk/return profiles of different investment choices and explaining the importance of diversification.

However, it can be difficult to find out further information on the role corporate bonds can play in a diversified portfolio – for example, below is an extract from the "Developing an investing plan" page[1]:

> *The way you structure your portfolio will depend on your financial goals, investing time frame and risk tolerance.*
>
> *For short-term goals, lower-risk investment options are better. Consider investments like a savings account, term deposit or government bonds. These investments are lower risk as they're less likely to fall in value and you can access your money.*
>
> *For longer-term goals, investments with higher returns such as shares and property, can be better. These investments are higher risk but you're investing long term, so you can ride out any short-term falls in value. [emphasis added]*

While this is only meant to be a high level overview, it is an example of the lack of coverage given to corporate bonds, which reduces investor awareness. Without this awareness, investors are unlikely to investigate further on the potential risks and returns of this investment product, and how this compares to other investment options.

We understand that the inquiry's terms of reference covers the tax treatment of corporate bonds. Given the different risk and return profiles of fixed interest products compared to equities and other investment types, it is not so simple (or appropriate) to compare the tax treatment of one investment type to another without regard to all these other features.

Recommendation

We would encourage ASIC and other market participants to increase investor awareness and understanding of the role corporate bonds can play in a diversified portfolio, particularly as a defensive asset providing lower risk and more stable returns.

Simplifying the issuance process for market participants

Australia's property sector has the capacity to meet this investor need and be a significant issuer of debt within the domestic market. However, the current regulatory environment for issuing corporate bonds broadly restricts issuances to the wholesale market with only a small contingent being available for retail investors.

[1] https://moneysmart.gov.au/how-to-invest/develop-an-investing-plan

The challenge

According to market participants, the main obstacle to the growth of a retail bond market in Australia is the issuance process – issuers are subject to extensive prospectus requirements which adds complexity, time and costs compared to wholesale bond markets.

Prospectus requirements

Under the *Corporations Act* all simple corporate bonds are required to complete a two-part prospectus made up of a base prospectus and an issue specific prospectus.

The base prospectus informs the prospective investor on:

1. The issuer – including information on management, directors, financial reports, governance arrangements, business strategy, trust deeds, financial ratios etc.
2. The bonds – including interaction between rate and yield, term of the bond, interest rates, maturity, events that constitute a default
3. Risks – including business risks and associated risks
4. Other information that the investor should consider

The issue specific prospectus must include specific information outlined in the regulations of the Corporations Act, including the size of the series, or tranche, to which the offer relates.

The requirements of the base prospectus and issue specific prospectus as outlined in 6D.2.04 and 6D.2.05 of the Regulations result in the following challenges for those seeking capital:

- The detailed requirements result in lengthy prospectuses which take significant time and cost to produce and can be challenging for investors to digest.
- For corporations listed on the Australian Stock Exchange (ASX), the majority of information required by 6D.2.04 of the regulations is already available for investors through the ASX and hence creates a regulatory duplication. This one size fits all structure in the Corporations Act for all simple corporate bonds creates a disincentive for listed entities in particular.
- The Regulations state that the base prospectus is only valid for three years requiring entities to refresh their full base prospectus at the end of this time.

By comparison, there is a stringent, well known process for raising equity in Australia which allows listed entities to raise additional equity off the back of half year or full year results with limited disclosure requirements.

This is a far less onerous process than the offering of a full base and issue specific prospectus which is required for retail bonds in Australia.

New Zealand experience

In New Zealand, the initial issuance of a retail bond involves the following documents:

- A short product disclosure statement
- A master trust deed
- An indicative term sheet

The New Zealand Financial Management Authority states that a Product Disclosure Statement for bonds, "*…will be no longer than 30 pages, or 15 000 words. It will explain who the issuer is, the reasons they are trying to raise money from you, and enable you to assess the likelihood they will pay you the money they are promising to pay.*" This is in comparison to Australian Base Prospectuses that are required to quote specific statements and caveats prescribed in the regulations.

New Zealand term sheets are used not only on the first issuance of a bond, but for subsequent bond issues. Term sheets are a far shorter version of the Issue Specific Prospectus and provide only the relevant information for the investor in the bond, including issuer, purpose, amount and maturity date.

These simplified term sheets are less compliance heavy than the Australian Issue Specific Prospectus and therefore less costly to produce. Term sheets are an internationally recognised form of bond information for retail investors being used not only in New Zealand but other international markets such as Singapore, all of whom have active retail corporate bond markets.

The advantage of the New Zealand system is that the product disclosure statement and the master trust deed do not require updating once they have been issued, reducing both the regulatory and financial impost that is current imposed on Australian listed entities.

This means that once the initial issuance is done subsequent issuances only require an indicative term sheet. These term sheets are limited in scope and simpler to produce than Australian issue specific prospectuses which are both lengthy and complex. Additionally, the added cost of producing a new base prospectus every three years adds additional cost to the bond, reducing the net capital raised compared with other jurisdictions.

Recommendation

These challenges could be addressed by reviewing the disclosure requirements of the Corporations Act with a view to streamlining the information required for each issuer and issuance.

In particular, we would strongly recommend a more streamlined approach for listed entities, given entity specific information is readily available and subject to continuous disclosure requirements. These changes would reduce the currently prohibitive time and costs currently associated with retail bond issuances.

Conclusion

As Australia seeks to reassert its competitiveness in the post-pandemic corporate world it is critically important that Australian investors have access to diverse investment choices and businesses have access to diverse and competitive funding mechanisms. The development of a retail corporate bond regime will achieve both these aims.

While it will take time to develop a mature retail corporate bond market in Australia, there are two critical actions that can be undertaken to facilitate this process, in particular:

- raising investor awareness of the important role corporate bonds can play in an investment portfolio, and
- creating a more streamlined regulatory environment for issuing bonds that would reduce the currently prohibitive time and cost barriers.

If you would like to discuss any part of this submission in more detail please contact, Collin Jennings on [redacted] or myself on [redacted]

Yours sincerely

[redacted]

Belinda Ngo
Executive Director – Capital Markets