

## Senate Standing Committee on Economics

### ANSWERS TO QUESTIONS ON NOTICE

#### Treasury Portfolio

Additional Estimates

10 – 11 February 2010

**Question: aet 53**

**Topic: Debentures**

**Hansard Page: Written**

**Senator WILLIAMS asked:**

1. With the intentions of ASIC, in Consultation paper 123 in renaming Debentures, why name debentures as unsecured notes, based on the Corporations Act s 283BH definition of ‘tangible assets’, where ASIC have elected to interpret the meaning of ‘tangible assets’ as not including mortgage and loan contracts as assets for the Trustee is given charge over for the purpose of debenture holders security?

This contrasts to ADI accounting standards that treat all loan contracts (including unsecured loans) as tangible assets. What is your view of fixing this problem by eliminating the interpretation of legal debate, by changing the Corporations Act to include a clause for the purpose of tangible property definition to include the term” CHOSSES IN ACTION”, as meaning things like money in the bank, loans and mortgage contracts, just at the ADI’s do now.

Further to this question, why are ASIC now looking to change the naming of debentures when there is little to be gained by this, and particularly since this has been the accepted naming for decades, for many of the Debenture issuing companies and who were given licences originally to trade in a product called a Debenture. To change this naming now will only add further to the confusion that surrounds the industry, and escalate the uncertainty that is in these products should they have to be renamed “Unsecured Notes” instead of Debentures. What purpose would it serve to change the name of this product now, for companies that have survived the GFC?

2. Given that ASIC are now about to further add confusion and uncertainty in the Debenture market by renaming debentures (from a long standing nomenclature) as unsecured notes (based on the whim of a legal interpretation), are ASIC trying to eliminate Debenture issuers from the financial landscape in Australia? This should be avoided at all costs given that they have a very important role to play, particularly in regional Australia

**Answer:**

1. In October 2009 ASIC released Consultation Paper 123 *Debentures: Strengthening the disclosure benchmarks* (CP 123), which proposes a discontinuation of the interim no-action position set out in Report 38 *High-yield debentures* (REP 38) in relation to when issuers can describe their products as ‘debentures’.

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The Corporations Act 2001 sets out special rules on when a security can be called a 'mortgage debenture' or 'debenture' or otherwise an 'unsecured note'.

A key determinant of whether a product may be called a 'debenture' depends on whether the obligation to repay the principal is secured by a charge over 'tangible property'. ASIC considers that 'tangible property' is property which has an actual physical existence, for example, goods and land. Tangible property is distinguished from intangible or incorporeal property such as choses in action (e.g. a receivable). ASIC considers that a charge in favour of a debenture trustee over a loan receivable by a debenture issuer does not constitute a charge over the 'tangible property' of the issuer. The Corporations Act therefore requires this type of investment to be called an unsecured note or unsecured deposit note.

In 2005, ASIC adopted an interim no-action position in relation to certain non-compliance with the naming restriction on when a product can be called a 'debenture'. The no-action position, in effect, allowed issuers to describe their products 'debentures' even if the charge in favour of the debenture trustee was only secured over property without an actual physical existence.

Some issuers that have failed over the last two years had described their products as 'debentures', even though the charge in favour of the trustee was not over tangible property with a physical existence. In ASIC's view, the term 'unsecured notes' more accurately describes the nature of these products than 'debentures'.

In CP 123, ASIC proposes to discontinue the interim no-action announced in 2005. The closing date for submissions on the proposal was 4 December 2009 and ASIC received 14 submissions. ASIC is yet to make a final decision on whether to proceed with this proposal.

The effect of ASIC's proposal would be that issuers will need to comply with the naming restrictions in the Corporations Act in certain documents. This is intended to increase consistency in how issuers describe their products, as well as promoting retail investor understanding of the risks associated with investments in these products. For example, in cases where the products is not secured by a charge over tangible property, there is a possibility that an issuer's structure, operations or other competing security interests will reduce the protection afforded to retail investors.

2. ASIC acknowledges that debenture companies play a role in the financial landscape. ASIC is continuing to work with debenture issuers, including those in regional areas, and will take their submissions into account in deciding whether to proceed with the proposals in CP 123.

ASIC is also mindful of the need to ensure that retail investors in these products are fully informed of the risks associated with their investments. Over the past few years, a number of debenture issuers have failed causing considerable loss to retail investors. ASIC's regulatory approach seeks to balance the interests of debenture issuers with consumers to ensure that new and existing debenture issuers inform those investing of the nature of their product and its associated risks.