



1 October 2007

By email: policy.submissions@asic.gov.au

Rhys Bollen
Regulatory Policy
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2001

Dear Mr Bollen

Consultation paper 89: Unlisted, unrated debentures—improving disclosure for retail investors

Consumer Action Law Centre (**Consumer Action**) is pleased to have the opportunity to comment on the Australian Securities and Investment Commission's (**ASIC**) consultation paper on unlisted, unrated debentures (the **Consultation Paper**). Consumer Action would like to congratulate ASIC on the consultation paper, it being a timely and necessary response to the recent collapse of a number of debenture companies, which resulted in significant losses to many small retail investors.

Consumer Action has not provided direct assistance to consumers in relation to problems with unlisted, unrated debentures or other high risk investments. For this reason, we do not have access to case-examples from our legal practice in this area. However, Consumer Action is interested in consumer policy generally, and believes the recent retail investor losses in relation to unlisted, unrated debentures demonstrates the limits of disclosure as a consumer protection mechanism. We welcome other regulatory responses, for example in relation to advertising and financial investment advice, which may impact investor decision-making more than disclosure.

Regulation of debenture issuers

Consumer Action takes the view that to solve the current problem, it is essential to determine the reasons debenture issuers have been able to raise significant funds for investments from retail investors that apparently offer poor risk-return ratios.¹ Possible reasons include:

¹ See CHOICE, *Fincorp update*, March 2007, <http://www.choice.com.au/viewArticleAsOnePage.aspx?id=105105>.

Consumer Action Law Centre

Level 7, 459 Little Collins Street
Melbourne Victoria 3000

Telephone

03 9670 5088

info@consumeraction.org.au

Facsimile

03 9629 6898

www.consumeraction.org.au

misleadingly advertising and marketing, inappropriate advice by financial advisers, and limits on ASIC's power to control debenture issuers.

Consumer Action believes that any analysis of the reasons that unsophisticated small retail investors invest in high risk investment products must include an understanding of the fact that many consumers do not fully and proportionately evaluate all available information before purchasing an investment. This finding about consumer behaviour holds true even when consumers are provided with disclosure documents such as a prospectus.² For this reason, Consumer Action believes that disclosure, while it should be promoted, is not always a mechanism that is sufficient to protect consumers.

(i) ASIC regulation and stop orders

Consumer Action takes the view that the stop-orders provisions in the *Corporations Act 2001* (Cth) are appropriately drafted, and were utilised effectively by ASIC in relation to the recent collapse of debenture companies. Consumer Action does not have the expertise to comment on whether an alternative system to stop-orders may be feasible or appropriate.

(ii) If not why not disclosure

Consumer Action generally supports the proposed 'if not, why not' disclosure regime outlined in the Consultation Paper. However, Consumer Action believes that the success of the implementation of a 'if not, why not' disclosure regime is dependant on a number of factors. Firstly, it is dependant on the premise that disclosure against benchmarks will provide information that retail investors can and will understand and effectively evaluate. Secondly, it is dependant on the premise that retail investors can and will understand and effectively evaluate the implications of a debenture issuer choosing not to disclose.

Retail investors of financial products are not a homogenous category. While a system of 'if not, why not' disclosure against benchmarks will assist some consumers in making better investment choices, it is not a complete solution to the current problem. Some consumers will not understand many of the concepts behind the benchmarks. Liquidity and loan-to-valuation ratios are two examples. Some consumers will focus on rates of return and discount concepts such as loan-to-valuation ratios may be less easily understood. Thus the 'if not, why not' approach does not fully resolve the problem that prospectuses are long complex documents, and that the information in them (if accurate) will not be fully utilised by some consumers.

Consumer Action believes an additional approach in relation to unlisted, unrated debentures would be to require warnings to be given to retail investors, either on the front page of the prospectus, or in a separate document. Such a warning would highlight in a simple way the risks to consumers, for example:

² Consumer Affairs Victoria, *Social Marketing and Consumer Policy*, Research Paper No. 4, March 2006, page 11. We note that in the case of the Westpoint group of companies, funding was raised from promissory notes which, due to an exemption (value greater than \$50,000), were not required to comply with the debenture disclosure provisions. We believe the Government should amend this exemption as soon as possible.

'Debentures are not like bank deposits, and carry a higher risk that you will lose your investment. This product is an unlisted, unrated debenture. Unlisted, unrated debentures are the highest-risk category of debentures.'

The use of simplified information that consumers can readily evaluate will redress some of the problem of consumers not rationally evaluating all information.

Consumer Action notes that inadequate, misleading and inaccurate disclosure is an additional problem faced by consumer. We do not, however, have the expertise or experience to comment on the effectiveness of stop-orders, civil penalty orders, and criminal prosecutions as remedies in relation to inadequate disclosure. If the proposed disclosure regime goes ahead, ASIC will be required to maintain a strong regulatory focus on the adequacy of disclosure information.

Advertising

Consumer Action supports ASIC's proposal to require advertisements for unlisted, unrated debentures to disclose the issuer's credit rating or, if it does not disclose this, to disclose a risk warning. Consumer Action supports the exclusion of certain words, and association with bank products from advertisements.

Consumer Action questions how issuers of unlisted, unrated debentures were able to misleadingly advertise in major newspapers and television advertisements for some time. The fact that they were indicates that current regulation of advertising has not operated effectively. Consumer Action believes that advertising that highlights high rates of return, and misuses words to increase consumers' feelings of 'security', may have a bigger impact on consumer decision-making compared with long and inaccessible disclosure documents. A look at advertisements that have been used shows that these advertisements contain simple information that is accessible to consumers (such as return on investment). The problem of misleading or inaccurate advertising is made more serious by the fact that disclosure in a prospectus may not counteract the effect of advertising. It is Consumer Action's view that statements in advertising should be consistent with risks as they are disclosed in prospectuses.

ASIC's proposals to require certain information in advertisements, and to prohibit certain statements may redress this problem. It may be worthwhile to consider whether changes to section 734 of the Corporations Act may make implementation of ASIC's proposals more effective.

Financial advisers

Consumer Action believes that an investigation into the role of financial advisers in the marketing of unlisted, unrated debentures to retail investors should be undertaken.

Table 12 Appendix 3 of ASIC's consultation paper lists financial advisers as a major source of information for retail investors. Considering the role financial advisers play in the choice by retail investors to invest in financial products, their role in the marketing of products to consumers needs to be examined further.

Investor education

Consumer Action supports ASIC's proposals to improve investor education. Consumer Action believes that such investor education should focus on unsophisticated, small retail investors who may not be accessing independent financial advice before making investments.


Conclusion

Consumer Action believes that whatever the reasons for retail investors' losses in relation to unlisted, unrated debentures, any solution to the problem must apply an understanding of the limits of disclosure as a consumer protection mechanism, and propose additional mechanisms to protect consumers.

Should you have any questions about this submission, please contact us on 03 9670 5088.

Yours sincerely

CONSUMER ACTION LAW CENTRE



Gerard Brody
Director – Policy & Campaigns



Neil Ashton
Policy Officer