**From:** John Davies
**Sent:** Wednesday, 8 February 2012 11:04 AM
**To:** Retail Corporate Bonds
**Subject:**

To: RetailCorporateBonds@treasury.gov.au

The Manager
Financial Services Unit
Retail Investor Division
The Treasury
Langton Cresent
Parkes, ACT 2600

Re; Discussion Paper – Development of the Retail Corporate Bond Market: Streamlining Disclosure and Liability Requirements.
Content ID: 2266

Dear Sir/Madam

I am a professional investor who has been active in Australia Fixed Interest markets for over 45 years. During that time I have witnessed the decline to insignificance of a once healthy vibrant secondary market for fixed interest securities. At the start of my working life many hundreds of Government Bonds were listed on the Stock Exchanges and were freely available to retail investors alongside semi-government bonds and bonds issued by semi-government instrumentalities, as well as company debentures, unsecured notes, etc. The secondary fixed interest market held the confidence of investors in the main, though it didn't prevent the collapse of the likes of Reid Murray or the Bank-affiliated finance companies who came unstuck by issuing too much for property developments in the 70's.

Why did all this change? For a number of reasons:

1) As the Australian Government gradually repaid all its maturing Bond issues.
2) The fund-raising activities of semi-government instrumentalities (Board of Works, Gas & Fuel Corp and State Electricity Commission) were rolled into State Government funding authorities such as the Victorian Treasury Corporation which reduced the number of offerings to the public.
3) Since then, both Federal and State Governments found it cheaper and easier to raise funds from local institutional and offshore investors.
4) The stronger equity markets since the 1980's, superannuation levy flows into equities and the desirability of franking credits all combined to make it easier and cheaper for Australian Corporates to raise equity capital rather than debt.

As a result, the secondary fixed interest market now consist mainly of Hybrid Fixed interest securities (pseudo-equities) which are predominantly floating rate, mostly convertible and sometimes offering franking credits. It is clear that for a retail Government, State Government and Corporate Fixed interest market to be re-established; all parties need to have a genuine and commitment to its re-establishment and its long-term success.

A couple of years ago the Australian government signalled that it wished to re-create an active primary and secondary market for fixed interest securities. Since then there has been an increase in

Corporate issues and secondary listings; but in my view these are generally heavily 'financial engineered' products from the same Investment Bankers that brought us the Global Financial Crisis.

I wish to make a few points in this regard:

1) The single most important ingredient for a viable retail fixed interest market is TRUST – trust by retail investors that their money will be safe. Looking at what is happening around the world in Debt markets clearly shows that there is a serious lack of it. I recently read an article reporting the testimony of John Pierpont Morgan given 100 years ago to the congressional committee that was "investigating" the role of large banks in the capital markets.
Here is the exchange between the committee's counsel Samuel Untermeyer and J.P.Morgan.
SU: Is not commercial credit based primarily upon money or property?
JPM: No, sir. The first thing is character.
SU: Before money or property?
JPM: Before money or anything else. Money cannot buy it....Because a man I do not trust could not get money from me on all the bonds in Christendom.
J.P.Morgan stood up and said that credit is primarily about trust -- trust in lending to a borrower who will pay back the capital under the agreed terms. The word credit itself is derived from the Latin word "credere," which means "to entrust." Unless retail investors can develop trust in markets and debt issues; they cannot flourish.
2) When I started in broking a wise old sage quoted the 'rule of 65' to me which proposed that a person at 65 years should have 65% of his assets in fixed interest securities and that the level of investment that a prudent person should have in fixed interest securities should increase with their age as they moved towards retirement. It appears to me that there is presently a significant imbalance in investment portfolios which presently appear to be over-invested in equities and under-invested in fixed interest securities; certainly in comparison to other countries in the developed world. This is especially important for superannuation funds as they increasingly move into pension mode and start to require steady and secure income flows. However, for this to occur investors will need to develop confidence and trust in the products being offered to them.
3) The over-investment in equities is clearly driven by the grossed up yields from equities after franking credits are included. This is a strong reason for investors to stay in equities; but not necessarily a prudent one.
4) To my knowledge, most recent new issues of fixed interest securities have been 'financially engineered' in a manner where it is difficult for the public investor to reasonably understand and to make a sound judgement of value and security.
5) What is needed is to create investor confidence in primary and secondary fixed interest markets; in my view, this can only be driven by better disclosure. If all new fixed interest issues were required to include a 'clear and concise, one page statement of disclosure', presented at the front of the document; rather than being spuriously hidden away in the fine print then we might be moving in the right direction; in addition by placing the onus for the statement of disclosure document on the issuer and the underwriter; then, we might make the complete terms and conditions of the issue accessible and understandable to private investors. The disclosure document should list; a) the ranking of the security in the overall debt structure of the issuer, b) the term of the security and any conditions that may extend the term, c) a statement regarding any convertibility conditions, d) a statement of interest payments including any conditions that might cease or defer interest payments.
6) It is in everybody's interests that Fixed interest markets be transparent, viable and stable; recent press reports that proposals are being considered to establish fixed interest exchange traded funds (ETF's) act against this and will increase the volatility of fixed interest markets which in my view is not desirable.

Yours faithfully
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