ASIC

Australian Securities & Investments Commission

INVESTING IN UNLISTED DEBENTURES AND UNSECURED NOTES?

Independent guide for investors reading a prospectus for unlisted debentures or unsecured notes

This guide is for you, whether you're an experienced investor or just starting out.

About ASIC

The Australian Securities and Investments Commission (ASIC) regulates financial advice, financial products and company laws to protect you. Our website for consumers and investors, MoneySmart, at **www.moneysmart.gov.au** offers you free and impartial tips and safety checks about the financial products and services we regulate.

How can this booklet help you?

Read this booklet together with the prospectus and remember:

- the return offered is not the only way to assess this investment: make sure you understand the risks
- the information in this booklet is general in nature. To work out a detailed strategy that meets your individual needs, consider seeking professional advice from a licensed financial adviser.

Visit ASIC's website for consumers and investors at **www.moneysmart.gov.au** for more independent information from ASIC about what to watch out for when investing.

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Key tips
from ASIC about investing

1. Anything you put your money into should meet your goals and suit you.

2. No one can guarantee the performance of any investment. You may lose some or all of your money if something goes wrong.

3. The rate of return offered is not the only way to assess how risky an investment is.

4. 'High return means high risk' is a familiar rule of thumb. Some investments, even if they seem to offer relatively moderate returns, can be extremely risky.

5. Take your time and do your research before deciding what to invest in. Visit ASIC's website for investors, MoneySmart, at **www.moneysmart.gov.au**, for more information.

6. You are taking a big risk if you put all your money into one investment. Spreading your money between different investment types ('diversification') reduces the risk of losing everything.

7. Consider seeking professional advice from a licensed financial adviser.

‘Listed’ and ‘unlisted’ investments

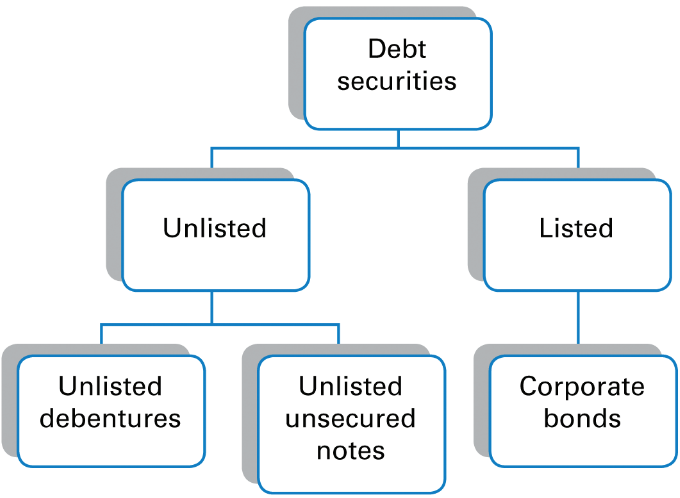
This is one of two investor booklets that look at different types of debt securities (investments). Separate booklets on other unlisted investments—mortgage funds and property trusts—are also available.

The diagram below illustrates some broad distinctions between debt investments available to investors, including unlisted debentures and unsecured notes, and listed corporate bonds.

This booklet looks at unlisted debentures and unsecured notes. This is where investors lend money to a company, which issues a promise to repay that money to investors at a future date, as well as interest.

The debentures and unsecured notes are ‘unlisted’ because they are not quoted (or ‘listed’) and traded on a secondary market, in the way that shares and corporate bonds, for example, are quoted on the Australian Securities Exchange (ASX). Instead, you typically deal directly with the company issuing the unlisted debentures and unsecured notes when you enter or exit the investment.

Corporate bonds are a separate category of debt investment and are generally listed investments. These are described in a separate booklet, *Investing in corporate bonds?*



Know what the investment is

What is a 'debenture' or 'unsecured note'?

Debentures or unsecured notes are a way for businesses to raise money from investors. In return for your money, the business (or 'issuer' of the debenture or unsecured note) promises to:

- pay you interest
- pay back the money you lend it (or your 'capital') at a future date.

An investment can only be called a debenture in documents relating to an offer if the security in place is over tangible property of the issuer. Unsecured notes, on the other hand, are generally riskier than unlisted debentures as there is no tangible property provided as security for investors. ASIC will require all businesses to follow this approach to the naming of debentures from 1 July 2011.

By investing in a debenture or unsecured note, you are lending your money to a business, with all the risks that this involves.

The issuer might use your money to finance a wide range of business activities. It might also lend your money to another business (known as 'on-lending').

Debentures and unsecured notes are 'fixed interest' investments. This means that the interest rate on the money you lend is set in advance. However, interest payments on your money and the return of your capital are not certain.

A debenture or unsecured note is not the same as a term deposit.

What is an 'unlisted' debenture or unsecured note?

An unlisted debenture or unsecured note is not listed on a public market, such as the ASX.

There are differences between unlisted debentures and unsecured notes and listed debt investments that can make it harder for investors to know what's happening with their investment. These differences include:

- The issuer of an unlisted debenture or unsecured note is not subject to stockmarket requirements to make information affecting the price or value of the investment publicly available.
- Unlisted debentures and unsecured notes are not listed on a stockmarket where you can see the price of the investment (and whether it is going up or down) and sell it if you want to.
- It can be harder to get out of the investment early.
- Trading in unlisted debentures or unsecured notes is not subject to the ongoing market supervision of ASIC.

Do your research

Before you invest in a debenture or unsecured note, it's important to understand the features and risks of the product.

A good place to start is the prospectus.

Why is the prospectus important?

The prospectus will tell you how the investment works, and you should read it in full. However, if you read nothing else, make sure you read the sections that:

- explain the key features and risks of the investment
- explain certain indicators or 'benchmarks' that can help you assess the risks of unlisted debentures and unsecured notes (see pages 10–18).

You should find this information in the first few pages of the prospectus.

The prospectus should tell you everything you need to know about the issuer, what it will do with your money, and the terms of the investment.

A prospectus must be lodged with ASIC before it can be used to raise money from investors. However, this does not mean that ASIC has in any way checked or endorsed the underlying investment.

Assess the risks

The return offered on an investment is not the only way to assess how risky it is. ASIC has developed 8 benchmarks that apply to unlisted debentures and unsecured notes to help you assess the risks.

Issuers must tell you in their prospectuses how they meet each benchmark. If they don't meet a particular benchmark, they must explain why, allowing you to decide whether you're comfortable with the explanation.

Here's how you can use ASIC's benchmarks to assess the risks in unlisted debentures and unsecured notes:

Look for information about each benchmark in the prospectus.

Review whether the issuer and/or investment meets the benchmark.

If not, does the issuer say how and why it deals with this risk in another way?

Decide if you're satisfied with how it deals with this risk.

If you're not satisfied with how the risks are dealt with, are you willing to risk your money in this investment?

Take your time and think things over before you invest. Get professional financial advice if you're unsure what to do.

Remember: Benchmarks are not a guarantee that an investment will perform well. Even if an investment meets all the benchmarks, you could still lose some or all of your money if things go wrong. The benchmarks are simply designed to help you understand the risks and make a decision about whether to invest your money.

ASIC's 8 benchmarks for unlisted debentures and unsecured notes

These benchmarks are designed to help you:

- understand the risks associated with these investments
- decide whether to invest your money

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2. Liquidity*	12
3. Rollovers*	13
4. Debt maturity*	14
5. Loan diversity†	15
6. Related parties†	16
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8. Loan-to-valuation ratio‡	18

* Benchmark applies to all issuers of unlisted debentures and unsecured notes.
† Benchmark applies to issuers that lend your money to someone else.
‡ Benchmark applies to issuers that use (or lend) your money for property-related activities.

Remember

- The benchmarks are not a guarantee that an investment will perform well.
- Even if this investment meets all the benchmarks, you could still lose some or all of your money if things go wrong.
- Any investment should meet your goals and suit you.
- ASIC does not endorse specific investments.

Benchmarks 1–4 apply to all issuers of unlisted debentures and unsecured notes

1 **Equity capital** means money the issuer has invested in the business.

To meet this benchmark, the issuer must have the following minimum equity capital:

Business activity	Equity capital
Property development	20%
All other types	8%

The issuer must also provide a comparative equity ratio from the prior year, so that investors can see if it has changed.

What's at stake for you?

If the issuer has less equity capital invested in the business, there might be no safety margin to tide things over if the business runs into financial difficulties. It could also mean that the issuer has less incentive to operate the business prudently and responsibly because less of its own money is at risk.

2 **Liquidity** means the issuer's ability to meet short-term cash needs.

To meet this benchmark, the issuer must:

- estimate its cash needs for the next 3 months
- ensure it has enough cash or other liquid assets to meet those cash needs. Liquid assets are assets that can be readily converted into cash
- 'stress test' its liquidity to see if it would have enough cash or liquid assets if there was a 20% decrease in the issuer's rollover or retention rates (see 'Rollovers' on page 13).

What's at stake for you?

Liquidity is an important measure of the short-term financial health of an issuer or business. An issuer that has insufficient cash or liquid assets might be unable to meet its short-term obligations (e.g. to run the business properly, pay you interest, or pay your money back at the end of the term).

3 Rollovers

Some investments are automatically rolled over at the end of the investment term. This may mean that your money is re-invested for a similar term unless you withdraw it.

To meet this benchmark, the issuer must clearly state in the prospectus what happens at the end of the investment term, including how it will update you with new information since you last invested.

What's at stake for you?

Make sure you keep up-to-date with your investment. Things might have changed—for both you and the issuer—since you first invested. You might prefer to withdraw your money rather than simply rolling it over for another term. Beware of notice periods that don't give you much time to act.

4 Debt maturity

This refers to the size, timing and cost of the issuer's borrowings. This information is important because it lets you know what other borrowings and debts the issuer has, how much interest it has to pay and when the loans will become due.

To meet this benchmark, the issuer should tell you:

- when its debts and other borrowings will fall due, by term and by value (the 'debt maturity profile'). This includes debentures and unsecured notes on issue
- about the interest rates, or average interest rates, applicable to these debts and borrowings.

What's at stake for you?

The issuer's debt maturity profile is a useful gauge of looming financial pressures. For example, an issuer that needs to repay a large amount of debt within a few months may be riskier than an issuer with a well-spaced repayment schedule. That's because the first issuer may need to use a large amount of cash to repay the debt, or to refinance it under pressure.

Benchmarks 5–6 apply to issuers that lend your money to someone else

5 Loan diversity

Just as you can spread your own investments to manage risk, an issuer can manage risk by spreading the money it lends between different loans and different borrowers. This is called 'loan diversity'.

To meet this benchmark, the issuer should tell you:

- its policy on loan diversity
- the maturity profile of its interest-bearing assets (e.g. its loans and investments) and its lending, by term and by value
- the interest rates, or average interest rates, applicable to these assets and loans
- how many loans it has by number and value including:
  - class of activity and geographic location
  - the proportion of loans that are greater than 30 days overdue, or are renegotiated loans
  - the proportion of total loan money that is lent on a 'secured' basis, and what the security is
  - the proportion of total loan money the issuer has lent to its largest single borrower and 10 largest borrowers
  - the proportion of loans that are subject to legal proceedings to recover debts.

What's at stake for you?

Is the issuer's loan portfolio heavily concentrated in a small number of loans, or in loans to a small number of borrowers? If so, there is a higher risk that a single negative event affecting one loan will put the overall portfolio (and your money) at risk.

It is also important to know the proportion of loans in default or arrears ('past due') and what the lender is doing to address this.

6 Related parties

A 'related party transaction' is a transaction (e.g. a loan) involving parties that have a close relationship with the issuer.

To meet this benchmark, the issuer must tell you:

- how many loans it has made to related parties and the value of those loans, both in dollars and as a percentage of the issuer's total assets
- how it assesses and approves related party loans
- about any policy it has regarding related party lending, including matters such as interest rates, security and loan-to-valuation ratios. ASIC expects that most issuers will have a firm policy on how they lend funds.

What's at stake for you?

The risk with related party transactions is that they might not be made with the same rigour and independence as transactions made on an arm's length commercial basis. There is a greater risk of the loans defaulting and therefore your money is at greater risk if:

- the issuer has a high number of loans to related parties
- the assessment and approval process for these loans is not independent.

Benchmarks 7–8 apply to issuers that use (or lend) your money for property-related activities*

7 Valuations

Knowing exactly what the issuer's underlying assets are worth (i.e. accurate valuations) can help you assess its financial position.

To meet this benchmark, the issuer must:

- tell you how often it gets valuations done (and how recent a valuation must be for a new loan)
- establish a panel of valuers
- ensure that no single valuer conducts more than one-third of the valuation work
- ensure that properties still being developed are revalued at least every 12 months, unless the funds are released in stages
- tell you about the valuation of a particular property if the property is 5% or more of the issuer's total property assets, or if the loan is 5% or more of its total loans
- value property in the following way:

Type of asset	Basis for valuation
Property (development)	'As is' basis and 'As if complete' basis
Other property, e.g. real estate	'As is' basis

What's at stake for you?

If the issuer does not include information about valuations in its prospectus, it will be more difficult for you to assess how risky the investment is. Keeping valuations up-to-date and shared among a panel means they are more likely to be accurate and independent.

* For example, property-related activities might include property development or mortgage financing.

8 Loan-to-valuation ratio (LVR)

This benchmark applies to issuers that on-lend money for property-related activities. The LVR tells you how much of the value of an asset is covered by a loan. The LVR is a key risk factor when assessing whether to lend money to someone.

To meet this benchmark, the issuer must:

- only on-lend money for property development in stages
- maintain the following maximum LVR (based on a valuation obtained under benchmark 7):

Business activity	Loan-to-valuation ratio
Property development	70% of the latest complying valuation
All other types	80% of the latest complying valuation

What's at stake for you?

A high LVR means that the investment is more vulnerable to changing market conditions, such as a downturn in the property market. Therefore, the risk of losing your money could be higher.

Think about your own situation and needs

Does the investment meet your goals?

Whenever you invest your money, it is important to have a financial goal in mind, and a strategy for meeting that goal. For example, your goal may be looking for a secure income for your retirement. Think about getting professional advice from a licensed financial adviser to help you develop a suitable investment strategy according to the level of risk you're comfortable with. Then measure all investments against that strategy.

Is it important to you to protect your capital?

Be careful about words like 'safe' and 'guaranteed' in advertisements. They might imply that the investment is secure, when in reality it is not.

Certain financial institutions like banks, building societies or credit unions are specially regulated by the Australian Prudential Regulation Authority (APRA) to make sure that, under all reasonable circumstances, they can meet their financial promises to you.

This type of regulation, called 'prudential regulation', protects you, for example, if you put your money in a term deposit with one of these institutions.

The Australian Government has guaranteed deposits in Australian owned banks, locally incorporated subsidiaries of foreign banks, credit unions and building societies (institutions known as 'ADIs'). This means that this money is guaranteed if anything happens to the ADI.

The government guarantee is automatic and free for deposits up to $250,000 per person per ADI. If you have more than $250,000 with one ADI then only up to $250,000 is guaranteed. Most issuers of debentures and unsecured notes are not subject to prudential regulation and do not have a government guarantee.

Have you spread your investments to manage risk?

Most people have heard the saying, ‘Don’t put all your eggs in one basket’. When it comes to investing your money, a good way of managing risk is to spread your money between different investment types, such as cash, fixed interest, property and shares. The spread will depend on your financial goals and how much risk you’re comfortable with. These different investment types are known as ‘asset classes’.

Spreading your investments to manage risk is called ‘diversification’. Just investing in debentures or unsecured notes is not diversification.

By spreading your money both across different asset classes and between different investments within the same asset class, you reduce the risk of losing everything. By putting only a proportion of your total funds into any one type of investment, you won’t lose everything if one investment produces poor results or fails completely.

What returns are you being offered?

‘High returns means high risk’ is a familiar rule of thumb. However, as with all rules, there are exceptions to look out for.

Some investments that appear to offer relatively modest returns can be extremely risky. That’s why it’s important to consider more than just the returns when deciding whether to invest in something.

When comparing rates of return, make sure you compare ‘apples’ with ‘apples’ (i.e. similar investments).

Can you get your money back early?

What happens if you need to get your money out before the end of the loan term? Is this an option and are there penalties for doing so?

If you need flexibility, think about investing in other financial products that allow you access to your money without heavy fees or penalties.

Do you know how risky the investment is?

Debentures and unsecured notes are generally a riskier type of investment than term deposits issued by banks, building societies and credit unions that are prudentially regulated in Australia.

Ask yourself, is the return you are being offered high enough to compensate you for the risk you are taking on by putting your money in this investment?

Can you accept the risks?

The main risk with this type of investment is that the issuer might be unable to pay you interest when it is due, or pay back your money at the end of the term.

If you don't understand the risks in this investment or you're not comfortable taking any risks with your money, look at other financial products instead. Get professional financial advice if you're unsure about an investment decision.

Do you know what you are investing in?

Check what the issuer plans to do with your money. This information should be clearly set out in the prospectus, but don't hesitate to ask questions until you really understand.

Knowing what your money will be used for can help you assess the risks and decide whether you are comfortable with this investment.

Is the investment related to property development?

If your money will be used for property development, consider these extra risks:

- Will the property development be completed on time and on budget?
- How is the property valued?
- How will the issuer meet cash flow needs before the property development is completed and sold?

The prospectus should help you to answer these questions.

People like to think that investing in property is 'safe as houses'. In reality, it involves the same risk as any other investment—the risk of losing as well as gaining money.

Misleading advertising? Hard sell?

Have you come across an advertisement for a financial product that you think is misleading?

Or have you been pressured by a sales person to make a decision when you didn't have enough information, or weren't sure that the product was right for you?

Phone ASIC on **1300 300 630** to tell us about it. You can lodge a formal complaint at **www.moneysmart.gov.au**.

See **www.moneysmart.gov.au** for some strategies to help you resist pressure selling, so you don't end up investing in a financial product that doesn't suit your needs.

For more information on what to look out for in general investing, go to **www.moneysmart.gov.au**.

The Australian Securities and Investments Commission consumer website, MoneySmart, offers you financial tips and safety checks

For consumers and investors: **www.moneysmart.gov.au**
ASIC's infoline on **1300 300 630**

ISBN 978–0–9805021–7–6