Threat to retail corporate bond market

Jonathan Shapiro

The threat of class actions brought against trustees of failed corporate debt offerings could further derail efforts to grow a retail corporate bond market, as two looming defaults weigh on the sector.

Individual investors that subscribed to bond offers by Mackay Sugar and ASX-listed Axsesstoday are facing the prospect of losses as a result of restructures and administration filings.

That has reignited concerns within the trustee industry about the litigation risks from providing services to issuers of notes, bonds and debentures.

Australian Executor Trustees, the 130-year firm acquired by ambitious fintech Sargon from IOOF, acts as the trustee for holders of both bond securities, and industry experts say it is one of the few companies prepared to provide the service on debt raisings to individuals. That is because trustees have paid out over $100 million in settlements to investors that lost money in fixed income-type offerings.

Trustees are typically appointed to protect the interests of investors in managed funds and superannuation funds, but are appointed to monitor security offerings on behalf of investors.

This includes assessing quarterly financial reporting of the issuer of debt, and stepping in to enforce the rights of security holders in certain instances.

But they have been targeted by class action law firms for their role in failing to prevent losses relating to note, bond and debenture issues.

As a result, fewer providers are willing to act as trustees, corporate bond advisers say, as it could prevent borrowers from tapping individual investors for debt financing.

"If trustees aren't willing to act on deals then there can't be a retail market. It drives people to the wholesale market," said a corporate debt adviser.

In October 2018, NSW courts approved a $28 million settlement of claims made against Australian Executor Trustees by investors in Provident Capital while in January 2018, Victorian courts approved a $64 million settlement of claims made against The Trust Company by investors in debentures issued by Banksia. The Trust Company also agreed to a $25 million settlement with investors in unsecured deposits issued by Australian Capital Reserve.

While regulators have tried to encourage more companies to raise debt directly from individual investors to foster a retail corporate bond market, only a small numberhave tapped individuals for debt financing.

This has either been done through specialist fixed income brokers, wealth managers and in rare instances through a listed bond offering.

While the major credit rating agencies do not assign ratings to retail bond issues, the securities sold to retail investors would most likely not achieve investment grade status. The higher risk of default and the potential litigation risk has meant few trustees are willing to act on corporate bond sales.

AET is an exception and is the trustee for almost all the ASX-listed senior bond issues. These include bonds issued by Dixon Advisory's US Residential Masters Fund, and bonds sales by Peet, Villawood, Australian Unity and Tatts.

One boutique trust company, Melbourne Securities Corporation, however, says it is selectively prepared to take on fixed income business.

MSC Group managing director Matthew Fletcher said the issue is highly sensitive to regulators and insurers due "to a number of recent settlements", but said the cases did not all relate to the fact that the offers were in fixed income. "We also believe that trustees are often brought into [class action claims] due to misunderstanding about their role, but also understand they are often incorrectly seen as the 'deep pockets' back stop."

Mr Fletcher credited an enhanced reporting regime introduced by the Australian Securities and Investments Commission, known as Regulatory Guide 69, for increasing transparency from note issuers about their financial status. Most settlements occurred before its adoption.

"We consider ASIC is in a difficult position simply as a result of recent retail investor losses, but it's a real opportunity for the regulator to develop debenture policy in consultation with market participants.

"The market definitely needs more certainty and we've seen companies struggle to meet commercial timeframes as a direct result of delays in seeking ASIC and trustee support."

Trustees have existed in Australia for more than 130 years, and act as legal fiduciaries to safeguard the interests of investors in funds, trusts and investment schemes. Australian Executor Trustees is one of the oldest trustee providers, It was established in 1878 after a young woman's inheritance was fleeced by opportunistic businessmen.

Last September the company was sold by IOOF to Sargon Capital for $51 million. "In assessing all acquisitions we evaluate the company's compliance with its obligations. We do not comment on specific clients or schemes," a Sargon spokesman said.

The trustee industry has existed in Australia for more than 130 years. PHOTO: PAUL ROVERE