# Getting into debt

## Why Australian investors need an active retail debt market

***While Australia can boast a healthy "institutional" capital markets structure and a vibrant and high-volume retail equity market, there has not traditionally been a viable retail debt market. ROSIE KENNEDY explains why an active retail debt market is now imperative.***

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A key factor behind the accelerating interest in the development of an active Australian retail debt market has been the increase in the number of individuals engaging in direct investments. According to an Australian Stock Exchange share ownership study issued in February 2000, 40.6% of Australians invest *directly* in equities — a staggering total of 5.7 million adults.

Even more striking is the number of investors who have entered the market recently. An estimated 2.1 million Australians have entered the sharemarket since 1998.

One of the reasons for this enormous growth, apart from a number of recent large floats (eg, AMP and Telstra), has been the ease of trading. That is, investors in Australia have for many years been able to trade and settle their securities electronically through the ASX automated equity trading (SEATS) and settlement (CHESS) systems. This has improved efficiencies and reduced the cost of trading and settling securities.

**THE NEED FOR DIVERSIFICATION**

While the growth in the number of investors in the sharemarket is a pleasing development, it is of some concern that new retail investors are rarely practising portfolio diversification. Retail investors have little choice, if they wish to invest in tradeable securities, but to invest in equity-based products. The latest APRA *Financial Institutions Report* (Third Quarter 1999) shows that if investors placed their money in a managed superannuation fund, they would on average have an asset allocation of:

26% . . . . . . . . . . . interest-bearing securities
48% . . . . . . . . . . . . . . . . . . . . . . . . . shares
9% . . . . . . . . . . . . . . . . . . . . . . . . . . cash
6% . . . . . . . . . . . . . . . . . . . . . . . . property
11% . . . . . . . . . . . . . . . . . . . . . . . . . other

However, recent figures on the asset allocation of "do-it-yourself" (DIY) investors show that these investors placed only 2% of their portfolio in interest-bearing securities (APRA *Report*, First Quarter 1998). This shows there is a major disparity between the asset allocation of institutional or professional investors and individual investors. In light of Australia's compulsory superannuation environment, Australia's DIY superannuants may be significantly exposed during an equity market downturn.

The lack of diversification of Australian investors compares unfavourably with the United States where there is evidence to suggest that retail investors have approximately 30% of their assets invested in interest-bearing securities.

Most investment advisers will agree that the right asset allocation can reduce the risk profile of a portfolio without significantly decreasing the return. The ASX believes Australians should have the opportunity to do this easily and efficiently.

Indeed, encouraging individuals to save through compulsory superannuation environments, and providing them with a structure in which they can make their own investment decisions, without providing them with the means to diversify their savings gives rise to concern.

Australia's regulatory environment, with its compulsory superannuation requirements continuing to rise, should be well able to foster a retail debt market.

**Viable alternative for borrowers**

While there are advantages in a retail debt market from a retail investor point of view, there are also benefits for Australian borrowers.

Companies wishing to borrow, especially those with a recognisable brand name, periodically tap into overseas retail debt markets. A healthy retail debt market in Australia provides companies with a viable alternative to overseas markets and allows companies to diversify their funding base and to choose which type of market best suits their borrowing requirements.

## WHAT HAS BEEN ACHIEVED SO FAR?

**Transparency**

Although the ASX has had debt securities quoted for many years, advisers unfamiliar with interest rate securities needed significant navigational skills to find them.

With the launch of the ASX's retail market in late November 1999, a separate SEATS page was created to group together quoted interest-rate securities. This page enables "equity focused" retail client advisers to monitor and trade these securities in the same manner as shares. It shows buy/sell quotes, maturity dates, coupons and other useful information about the securities.

There is also a capability on SEATS to convert the price to a yield (for vanilla interest-rate securities). Another important step forward was for this information to be distributed to a wider audience. For example, Bloomberg now has a separate page replicating the SEATS screen and IRESS places the securities together in a similar manner. *The Australian Financial Review* has begun reporting separately on income securities.

**Electronic settlement**

One of the greatest inhibitors to trading interest-rate securities has been the need to settle these transactions physically. The ASX has not only introduced electronic trading but has also enabled debt securities to be settled via CHESS — as are shares.

This significantly changes the economics of trading interest-rate securities from a retail perspective. It can now be as simple and cost-effective to buy and sell retail interest-rate securities as it is to buy and sell shares.

**Education**

The ASX acknowledges that more work is required to improve the general level of education about interest-rate securities. In light of this, the exchange has produced and distributed three educational booklets, run courses and investor hours, and it has an extensive educational component on its website. Greater commitment to highlighting the benefits of development of this market is beginning to filter to other educational organisations and financial advisers.

## WHAT ELSE NEEDS TO BE ACHIEVED?

A number of barriers to future growth need to be addressed. These relate mainly to factors that hinder supply of securities, such as:

- perception of prospectus costs ; and
- poor accessibility of commonwealth government securities.

One the main impediments to the development of an active retail interest-rate market in Australia has been prospectus requirements that are seen by issuers of debt securities to be too onerous. The ASX has been encouraged by federal authorities, who have indicated that they believe the CLERP 4 changes (which took effect on 13 March 2000), provide sufficient flexibility to accommodate the special needs of debt-security issuers.

This view was confirmed by regulatory authorities at a Debt Prospectus Forum organised by the ASX last March, which provided considerable comfort to issuers and their legal advisers, who previously interpreted the legislation conservatively.

Commonwealth government securities (CGS) are the premier, effectively risk-free, fixed-interest security and the logical "first" interest-rate investment for retail investors. The ASX receives regular requests from investors and brokers to provide a market for these securities and believes it is important that investors are able to buy and sell them as easily as shares.

However, while CGS are quoted on the ASX, they cannot be settled through the CHESS electronic settlement system as there is no provision in the Commonwealth Inscribed Stock Act (1911) for electronic settlement of CGS.

Consequently there is currently no readily accessible market for such securities. Investors must either purchase CGS from the Reserve Bank directly or request one of the specialist brokers to hold those securities on their behalf. Retail investors have no way of knowing if the value of the security is "at market" and the settlement process is cumbersome and time-consuming.

However, the government has indicated that the necessary changes to the Inscribed Stock Act will be effected in early 2001. By facilitating access to CGS, the government and the ASX will enable superannuants to diversify into a "risk free" interest-bearing investment and provide a further boost to the retail bond market.

The ASX has provided a market structure in which investors can easily trade, settle and monitor their securities. In the second half of last year $5.2 billion was invested in ASX-listed perpetual floating rate securities. The attractiveness of these securities, compared with bank fixed deposits and cash management trust investments, combined with their ability to trade and settle on the ASX, were the major factors influencing this strong flow.

The Commonwealth Bank has paved the way this year with a $750 million "Commets" issue which can be accessed by both retail and wholesale investors. This represents a significant step and has proved beyond doubt that there is real demand for a steady income flow by retail investors.

Trading volumes have continued to grow steadily since the market was launched, an encouraging sign from a market that is only nine months old.

In these times of compulsory superannuation, an aging population and potentially volatile markets, it is imperative that investors have an easy mechanism to diversify their portfolios and receive a steady income flow. A robust retail debt will significantly help investors achieve this. J