

26 August 2014

Mr David Murray AO  
Chairman  
Financial System Inquiry  
GPO Box 89  
Sydney NSW 2001

Email copy: [fsi@fsi.gov.au](mailto:fsi@fsi.gov.au)

Dear Mr Murray,

### **Supplementary Submission to the Financial System Inquiry**

Wilson Asset Management Group ('Wilson Asset Management') makes this second round submission ('Supplementary Submission') to the Financial System Inquiry ('FSI') in response to some of the observations made in the FSI's Interim Report regarding retail investors and equity raisings, and to provide our view on the policy option for consultation regarding additional protections for retail investors relating to the use of private placements and non-renounceable rights issues.

Under the heading 'Access for retail investors to new equity offers', the Interim Report focuses on the dilution of retail investors through capital raisings and notes that some submissions "argue that rules relating to these secondary equity issues should be modified such that 'dilution' cannot occur."<sup>1</sup> Footnote 116 following this statement appears to suggest these submissions argue for regulation restricting companies from raising capital from institutional investors without prior shareholder approval. The Interim Report fails to address the fact that retail shareholders are excluded from participating in private placements without the use of a prospectus or give consideration to a change to current regulations to improve access for retail investors to new equity offers by allowing them to participate in private placements without a prospectus and so place them on an equal footing with wholesale investors.

This Supplementary Submission and our initial submission of 28 March 2014 ('Initial Submission'), attached for your reference, specifically address the fact that under the current legislative regime retail investors are unfairly excluded from participating in capital raisings via private placements by Australian Securities Exchange ('ASX') listed entities without the use of a prospectus. Because of this unfair exclusion, retail investors have been prevented from accessing \$170 billion of new equity issued over the last 10 years to wholesale investors through private placements at an average discount of 7.8 per cent to the prevailing market price.<sup>2</sup>

In our view, given the existing ASX continuous disclosure regime is deemed to provide retail shareholders with a sufficient level of protection to participate in the secondary capital market (buying and selling shares 'on-market'), listed entities complying with the disclosure rules should be permitted to issue new equity to these retail investors without further disclosure. Currently, there are instances where retail investors can participate in primary capital raisings without the use of a prospectus – as discussed further below. By enabling all investors (retail and wholesale) to participate in primary equity raisings without the use of a prospectus, this would reduce the costs of raising capital for companies, particularly smaller companies, and increase the pool of capital they can draw on.



**WILSON**  
ASSET MANAGEMENT

Therefore, as set out in our Initial Submission, we make the following recommendation:

**Recommendation:**

***We recommend that regulations be adopted to enable all investors (retail and wholesale) to participate in primary equity raisings without the use of a prospectus, for entities listed on the Australian Securities Exchange ('ASX').<sup>3</sup>***

**Continuous disclosure regime offers sufficient protection**

Under the current legislative regime, retail shareholders are prevented from participating in a capital raising by a listed company through the issuance of new securities without a prospectus, except if the retail investor is classified as a professional or sophisticated investor ('wholesale investors') and therefore exempt under Section 708 of the *Corporations Act 2001* (Cth). The policy rationale for this position is that retail shareholders should be afforded an additional protection to wholesale investors when participating in capital raisings by private placement. In our view, the current legislation preventing retail investors from participating in private placements without a prospectus is anomalous and inequitable.

The risk of retail investors not having current information or 'full disclosure' about a company is addressed by the fact that the company is a listed entity and required to comply with the ASX Listing Rules, particularly the continuous disclosure requirements. The purpose of the continuous disclosure regime is to ensure all relevant information about a company's securities trading on the ASX is available to all existing and prospective investors. While a retail investor is considered to need disclosure-based protection when subscribing for new shares, they are not given the same protection for buying the same shares 'on-market'. Retail investors can participate in the secondary market by buying and selling shares in a company but they are not permitted to participate in the primary market when the same listed entity wishes to raise capital by issuing new shares.

Section 708AA of the Corporations Act allows listed companies to raise capital via a rights issue (pro rata issuance of new securities) to all shareholders without a prospectus. The Section expressly acknowledges the listed company disclosure requirements. Further, class order relief CO [09/425] Australian Securities and Investment Commission ('ASIC') allows a listed company to offer up to \$15,000 worth of shares per shareholder (retail and wholesale alike) every 12 months without a prospectus. The policy reason behind this class order and Section 708AA is that shareholders are sufficiently informed under the ASX Listing Rules, particularly the continuous disclosure rules.

**Increased access to equity markets for companies, including small and mid-caps**

As observed in the Interim Report: *"Almost 90 per cent of ASX-listed companies, or around 2,000, have a market capitalisation below \$300 million...For mid-caps, the cost of issuing equity can be prohibitive. Compared to large corporates, mid-caps face disproportionately larger fixed costs of issuance. In addition, because mid-caps are generally not well known, they may have additional promotional costs. They are also less able to absorb costs associated with listing..."*<sup>4</sup>

In our experience having raised capital from both retail and wholesale investors, the cost of a retail placement through a prospectus was double that of a private placement to wholesale investors. In addition, the production of a prospectus was complex and involved significantly more of the Board's management and time than the private placement to wholesale investors. Further, the time it took to raise capital using a prospectus was considerably more than the wholesale placement.

In our view, because of the financial and capacity constraints of many small and mid-cap companies and their management, the costs and complexities associated with raising money from retail investors through a placement with a prospectus has resulted in companies favouring capital raisings to wholesale investors over retail investors. Placing retail investors on

an equal footing with wholesale investors by allowing them to participate equally in private placements (without a prospectus), will likely reduce the costs of raising capital for companies and increase the pool of capital they can draw on including the more than \$500 billion invested by retail shareholders through SMSFs.

### **Additional protections for investors a negative**

We wish to respond to one of the 'Policy options for consultation' in the Interim Report, specifically the option regarding the introduction of additional protections for investors in relation to the use of private placements and non-renounceable rights issues.

We strongly disagree with this policy option, particularly any further protections for retail investors requiring additional disclosure for such capital raisings. As set out in this Supplementary Submission and in our Initial Submission, the current continuous disclosure requirements for listed entities are deemed sufficient to ensure adequate protection to retail investors for trading in the securities of listed entities, and participating in non-renounceable rights issues and share purchase plans (SPPs). Therefore, in our view if a listed entity is complying with the continuous disclosure rules in raising capital there is sufficient information available for retail investors to ensure that they are adequately protected.

***Any further disclosure requirements aimed at introducing additional protections for investors have the potential to reduce access to capital markets by retail investors and increase the costs of raising capital, particularly for small and mid-cap companies.***

### **New Zealand securities law reform precedent**

New Zealand has recently passed securities law reforms that provide that a prospectus is not required for any offer of securities that are in a class that are already traded on the New Zealand Stock Exchange.<sup>5</sup> As long as the company is listed on the New Zealand Stock Exchange, retail investors are able to participate in the issuance of securities without the listed company having to issue a prospectus. We contend the policy rationale for the applicable Australian and New Zealand laws are the same. To remain regionally competitive, Australian alignment with the New Zealand reform must at least be maintained.

### **Further information**

Should you or any other member of the FSI require any further details, we would welcome the opportunity to meet with you to discuss our submission.

Yours sincerely



*Geoffrey Wilson  
Chairman  
Wilson Asset Management*



*Kate Thorley  
Chief Executive Officer  
Wilson Asset Management*

Attached:

Wilson Asset Management Submission to the Financial System Inquiry, 28 March 2014

<sup>1</sup> FSI Interim Report, Section 3: Funding, sub-section 'Equity market'

<sup>2</sup> Dealogic

<sup>3</sup> The term 'primary equity raisings' is used in this context as companies issue new shares in the listed entity through private placements - that is, securities are created for the first (or primary) time. We acknowledge that such private placements may often be referred to as 'secondary capital raisings'. In the Interim Report, references to "secondary capital raisings by listed entities" and "secondary equity issues" appear to refer to capital raisings including private placements.

<sup>4</sup> FSI Interim Report, Section 3: Funding, sub-section 'Equity market' under the heading "Access to equity capital markets"

<sup>5</sup> Financial Markets Conduct Act 2013 (NZ)