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**FINAL SUBMISSION TO THE FINANCIAL SYSTEM INQUIRY: OMISSIONS RELATING TO THE LISTED  
EQUITY CAPITAL MARKET & OMB'S TECHNOLOGY FROM THE FSI FINAL REPORT**

Dear Panel Members,

On-Market BookBuilds (OMB) welcomes the opportunity to provide a further submission to the Financial System Inquiry (FSI) following the release of the Final Report on 7<sup>th</sup> December 2014.

The Panel should be commended on the broad scope of its recommendations.

However, we would like to bring your attention to some notable omissions from the Final Report, particularly since these issues were raised in the Interim Report of 15<sup>th</sup> July 2014.

I. Equity Market: Access to equity capital markets

The section in the Interim Report dealing with efficient capital raising (Page 92) was omitted from the Final Report.

No reasons or explanations have been given for the omission.

II. Technology: Improving competition

The Final Report (Page 27) stated *"The Inquiry's recommendations seek to provide more facilitative settings that enable financial firms to innovate increasing competitive tension, delivering greater efficiency and enhancing user outcomes."*

No guidance is given about how this might occur for capital raisings in the listed equity market.

Our recommendations for regulatory change in our previous submissions addressed and provided solutions to these issues.

The omissions are perplexing for the following reasons:

- 1) A contemporaneous UK Government inquiry – the Lord Myners Review, released 16<sup>th</sup> December 2014 – into how best to conduct Government privatisations and IPOs *“strongly recommended”* OMB’s technology to businesses and Government.

However, while recognising the importance of Australian technology and innovation, the FSI Final Report did not acknowledge the problem or that Australia is providing a world-first solution.

- 2) Capital raisings in the Australian listed equity market are amongst the least efficient of the world’s major markets, yet the Final Report made no mention of this section of the capital market, choosing instead to focus on crowdfunding.

It should be recognised that ASX has taken steps to alleviate this by being the first exchange to make the OMB technology available.

- 3) There were a number of complementary submissions from market participants that alerted the FSI to the distortions evident in capital raisings in the listed equity market, including the lack of access given to retail investors to placements conducted by continuously disclosing entities.
- 4) Despite the FSI’s focus on innovation, there was no reference to advances in capital raising technologies available to listed companies or companies wishing to list, or references to potential regulatory changes that would encourage use of these technologies.

More detail on each of these points is given below.

### **1. UK Government Inquiry into the Future of Capital Raising Methods**

Following the IPO of Royal Mail in the UK, the Lord Myners Inquiry (entitled ‘IPOs and Bookbuilding in Future HM Government Primary Share Disposals’ and released 16<sup>th</sup> December 2014) considered appropriate alternatives for future sales of Government assets and capital raising methods generally. The report *“strongly encouraged”* OMB’s technology, referencing it as follows:

*“In Australia an innovative hybrid between auctions and bookbuilding has been developed. This system aims to allow fair, orderly and transparent pricing and allocation of new securities ‘on-market’ by using the existing stock exchange infrastructure...”*

*“The growth of online auctions – such as the Australian system described above – across geographies, products and services is inevitable at some time in the future and will find a role in IPO pricing and distribution. Such a facility should be to the advantage of both sellers and buyers and address many of the concerns about potential conflicts of interest which lie at the heart of bookbuilding.”*

*“We welcome the principles behind this approach and strongly encourage this and any other digital auction method that helps to remove gaming from the process and brings wider transparency to enhance price discovery.”*

The consultation process involved more than 100 global market participants and made 8 recommendations – one of which was to encourage Government and business leaders to

*“... take up the challenge to transition book building towards a more auction-like, transparent mechanism and simultaneously to work proactively to develop digital online auctions given that these address concerns raised with us regarding bookbuilding.”*

OMB’s technology is currently operating in Australia via ASX BookBuild. The recommendations made by the Lord Myners inquiry has put the OMB technology in the sights of multiple international exchanges and has increased its international visibility.

We note that an inquiry commissioned by the UK Government endorsed an Australian innovation, while a contemporaneous Australian inquiry has not.

## **2. The Inefficiency of Capital Raising in Australia’s Listed Equity Market**

One of the terms of reference of the FSI was stated as *“to recommend policy options that promote the efficient allocation of capital and cost efficient access and services for users.”*

The problems associated with the traditional capital raising practices in the listed equity market, which were outlined for further debate in the Interim Report, were specifically addressed in the recommendations provided in our previous submissions.

We can re-send the empirical data showing that the cost of raising equity is substantially more for Australian listed companies than in all other developed markets, if required.

## **3. Retail Investor Participation – Complementary Submissions**

The spirit in which regulation for additional disclosure for capital raisings in the listed equity market was originally intended was to benefit retail investors. These protections are dwarfed by the discount associated with placements (still the most common form of issuing new equity in Australia) and dilution to retail investors’ existing holdings. Retail investors and small shareholders were excluded from over \$13bn of capital raised via placements in 2014, and \$66bn over the last 5 years.

We would like to draw the panel’s attention to other FSI submissions by market participants that demonstrate a broader acknowledgment of the disconnect between retail investors and capital raisings in the listed equity market.

Australian Shareholders Association (ASA) wrote:

*“Retail investors were diluted out of more than \$10 billion worth of value during the raft of capital raisings which occurred in the immediate aftermath of the global financial crisis. The primary causes were discounted institutional placements with no follow-up SPP (Share Purchase Plan), unfairly restricted SPP’s, a lack of renouncability in entitlement offers, separate book builds to deal with institutional and retail shortfalls and poorly marketed retail offers and limits on the ability of shareholders to apply for additional shares in entitlement offers.”*

WAM Capital wrote:

*“By allowing retail investors (and by definition SMSF’s) to participate in the placement of securities, the intermediation costs (the current discount to market price of the placement) will be shared with retail investors. This will likely reduce the company’s cost of issuance. Both outcomes are attractive for the effective development of the Australian capital markets...”*

Burrell Stockbroking wrote:

*“...Given continuous disclosure for listed entities, it should be possible to further relax product disclosure statement requirements for new capital raisings in a continuously disclosing entity...”*

#### **4. Advances in Technologies that Enable Fair, Efficient Capital Raisings**

As outlined in our initial submission, significant advances in technology now allow capital raisings by listed companies to be conducted ‘on-market’ – fairly, transparently and efficiently. We note and commend the comment in the FSI Final Report (Page 143):

*“For the financial system, technology driven innovation is transformative. New business models, products and services are emerging, driving competition and changing the way users interact with the system.”*

There was no guidance pertaining to technological advances in capital raisings conducted by listed companies or by companies wishing to list, despite the fact that the equity markets are critical financial infrastructure for Australia and certainly central to our financial system.

#### **Summary**

We agree wholeheartedly with the thematic of the FSI that technology should drive innovation throughout the economy, however we note that the Final Report did not provide guidance as to how this might occur in capital raisings in the listed equity market.

The technology that allows capital raisings to be conducted fairly, efficiently and transparently 'on-market' exists and has been offered on ASX since October 2013. In addition, the OMB technology (via ASX BookBuild) provides an innovative solution to the conflicts of interest conundrum that market participants are currently presented with.

Yet without new regulations, or even acknowledgement from influential bodies such as the FSI, market practices in Australia are unlikely to evolve to meet the technological solutions presented.

We note the FSI Chairman David Murray's comment at the recent Australian Centre for Financial Studies event in Melbourne that "*technological advancements were directly tied to improving competition in the financial services sector*" and that when it came to focusing on improving the quality of the financial system, one of the key areas that the FSI panel wanted to explore was "*getting more value from competition in the banking sector and elsewhere.*"

We thank you in advance for your consideration and look forward to guidance in relation to the omissions noted.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Ben Bucknell".

CEO  
Ben Bucknell

A handwritten signature in black ink, appearing to read "Rosemary Kennedy".

Managing Director  
Rosemary Kennedy

#### **About On-Market BookBuilds Pty Limited**

On-Market BookBuilds (OMB) is a privately owned company that developed and owns the intellectual property behind the unique bookbuilding technology licensed to the Australian Securities Exchange. OMB is independent of the ASX and the submissions herein are entirely its own, having regard to the one-on-one meetings conducted over the last 3 years with more than 250 listed companies, all investment banks, all broking firms, more than 50 legal firms, a significant number of institutional investors and Australia's leading peak bodies in finance.