

28 March 2014

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

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WILSON
ASSET MANAGEMENT

Dear Mr Murray

Submission to the Financial System Inquiry

The Wilson Asset Management Group ('Wilson Asset Management') is a strong advocate for all shareholders (retail and wholesale) to be treated equally and equitably when investing in the Australian equity market.

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').

Background

Wilson Asset Management is an investment management company owned and operated in Australia. We are the investment manager of three ASX listed investment companies - WAM Capital Limited (ASX: WAM), WAM Research Limited (ASX: WAX) and WAM Active Limited (ASX: WAA). We manage \$816 million on behalf of 19,180 shareholders. Our shareholders are retail investors, with in excess of 45 per cent being Self Managed Superannuation Funds (SMSFs).

Private placements - the equal treatment of all investors (retail and wholesale)

Wilson Asset Management proposes that all investors, those classified as sophisticated or professional investors (i.e. 'wholesale investors') and those that are not considered wholesale investors (i.e. 'retail investors'), be able to participate in the placement of securities by entities with continuously quoted securities listed on the ASX.

In the last 10 years \$340 billion¹ of capital has been raised by Australian listed companies, of which 50 per cent (\$170 billion¹) was through selective private placements made to wholesale investors. The private placements to wholesale investors raised capital at an average discount of 7.8 per cent¹ to the prevailing market price. To this extent, wholesale investors have been advantaged over retail investors to the sum of \$13 billion by the imposition of a regulatory exclusion.

Distinction between retail and wholesale investors

For corporate issuers, the distinction between retail and wholesale investors is drawn in Section 708 of the *Corporations Act 2001* (Cth). Companies are required to issue new securities under a prospectus unless the issue falls within one of the specified exemptions under Section 708. Exemptions include the issuance of securities to sophisticated investors, professional investors, or financial services licensees broadly defined as 'wholesale investors'. A prospectus is required when issuing new securities to the remaining classes of investors defined as 'retail investors'.

Chapter 7 of the *Corporations Act 2001* (Cth) draws a similar distinction for registered managed investment schemes although the tests for establishing a SMSF as a wholesale investor are considerably more stringent. Australian Securities and Investments Commission (ASIC) consider that a SMSF must be a retail investor unless the fund controls at least \$10 million.

Capital Raising

The ASX Listing Rules allow listed companies to issue up to 15 per cent of new equity on a non-pro rata basis per year, with a concession for smaller companies to raise new equity of up to 25 per cent with prior shareholder approval.

Our experience is that companies raising capital under these rules will typically do so by undertaking a private placement to wholesale investors. The cost for a company to issue a prospectus to retail investors is considerable both in terms of direct expenses and management and board time. In most circumstances, these factors make it prohibitive for companies to access the retail market. This is particularly the case for smaller capital raisings and for small to medium sized organisations where balance sheets and management resources tend to be constrained.

WAM Capital Limited

WAM Capital has recently raised capital from both the retail and wholesale markets. In 2013, WAM Capital raised capital through a private placement to wholesale investors using the ASX Bookbuild facility. Prior to this in 2012, it issued new capital to retail investors via a prospectus. Based on our experience raising capital via these two methods, we have the following observations:

- The cost of the retail placement through a prospectus was double that of the private placement to wholesale investors.
- From the time the retail placement was announced to its completion was a period of 11 weeks (73 days). The time from the announcement to completion of the wholesale placement was a period of seven (7) days.
- The production of the prospectus for the retail placement was complex and involved significantly more of both the management and the board's time than the private placement.
- On WAM Capital announcing the private placement, we received a significant amount of correspondence from our shareholders expressing their disappointment at being excluded from the placement due to the current government legislation.

As a consequence of Section 708 of the Corporations Act, it is less cost efficient and less time efficient for companies to issue a prospectus and accordingly, they access the capital market by private placement to wholesale investors. Retail investors are excluded from participation in these placements.

Continuous disclosure regime

It is acknowledged that the objective of a prospectus is to provide information about the company, and ultimately it is intended to provide a level of protection to retail investors when assessing whether to invest or not in securities being issued.

There is much debate into the usefulness of prospectuses, and we would argue there is a consensus view in the market that they are costly and time-consuming to produce and, in their current format, not overly useful for retail investors who generally do not read them.

The risk of investors not having current information or 'full disclosure' about a company issuing new securities is addressed where the company is listed on the ASX. The ASX Listing Rules and particularly the continuous disclosure regime purpose is to ensure that all relevant information is available for all investors (both to current shareholders and potential new investors) for the company's securities to trade each day on the stock exchange.

All investors (wholesale, retail, existing shareholders and potential new shareholders) can participate in buying and selling shares on stock market. The ASX Listing Rules ensure there is full disclosure of each company's relevant information and therefore provides protection for all investors.

The listed company disclosure requirements are expressly acknowledged in Section 708AA of the Corporations Act that allows listed companies to conduct rights issues (pro rata issuance of new securities) to its shareholders without a prospectus. Furthermore, in class order relief CO [09/425] ASIC allows a listed company to offer up to \$15,000 worth of shares per shareholder every 12 months without a prospectus.

The policy reason behind Section 708AA and the class order relief is that shareholders are sufficiently informed under the ASX Listing Rules, particularly the continuous disclosure regime.

In our view, the regime for placements to wholesale investors is unequitable and also defies logic. Section 708 of the Corporations Act permits a listed entity to undertake a placement of shares to wholesale investors. If the issuer is a listed entity whose securities have been traded on ASX for at least three months, under section 708A of the Corporations Act that investor may then immediately sell those shares on-market to retail investors. In other words, while a retail investor is considered to need disclosure-based protection when subscribing for shares, they are afforded no such protection if they wish to buy the same shares on-market.

In essence, the pricing differential between wholesale and retail investors is entrenched in the regulatory framework for placements. Wholesale investors have the ability to realise a profit on placements at the expense of retail investors.

Wilson Asset Management contends that, as investors are sufficiently informed for trading of the company's securities to occur each day on the ASX and for the company to conduct a rights issue or share purchase plan, they are sufficiently informed to participate in the placement (not pro rata) of the company's securities.

Benefits to Australian capital markets

The superannuation market (approximately \$1.7 trillion²), and particularly the SMSF segment (\$532 billion³), is a significant source of capital to fund Australia's growth. By allowing retail investors (and by definition SMSFs) 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 company's costs of issuance. Both outcomes are attractive for the efficient and effective development of the Australian capital markets.

New Zealand securities law reform – level playing field for retail investors⁴

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. 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.

Conclusion

Wilson Asset Management is categorised as a wholesale investor and therefore is a beneficiary of the current legislation restricting retail investors from participating in private placements. We believe all shareholders (retail and wholesale) should be treated equally and equitably when investing in the Australian equity market. It is this belief that has encouraged this submission.

Wilson Asset Management 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 ASX.

If you have any questions in regards to this letter, please feel free to contact us.

Yours sincerely



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Chairman
Wilson Asset Management



Kate Thorley
Chief Executive Officer
Wilson Asset Management

¹ Dealogic

² Based on latest APRA statistics

³ ATO statistics

⁴ Financial Markets Conduct Act 2013 (NZ)