
COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

**Reference: Corporate Law Economic Reform Bill 1998**

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## JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

### Tuesday, 23 March 1999

**Members:** Senator Chapman *(Chair)*, Mr Sercombe *(Deputy Chair)*, Senators Conroy, Cooney, Gibson and Murray and Ms Julie Bishop, Mr Ross Cameron, Mr Rudd and Dr Southcott

**Senators and members in attendance:** Senators Chapman, Conroy, Cooney, Gibson and Murray and Ms Julie Bishop, Mr Ross Cameron, Mr Rudd, Mr Sercombe and Dr Southcott

**Terms of reference for the inquiry:**

Corporate Law Economic Reform Program Bill 1998

### WITNESSES

**Committee met at 4.38 p.m.**

**CROSBY, Mr William Stuart, National Manager, Listings, Australian Stock Exchange**

**HAMBLETON, Ms Deborah Gail, National Listings Counsel, Australian Stock Exchange**

**CHAIR**—I declare open the hearing of the Joint Committee on Corporations and Securities. The purpose of this hearing is to take evidence on the Corporate Law Economic Reform Program Bill 1998. This is the fifth public hearing on this particular inquiry. The committee has received 35 written submissions which it will consider, along with the evidence it receives today, in preparing its report.

The committee prefers to conduct its hearings in public, but if at any time there are any matters you wish to discuss with the committee in camera, you may request to do so and the committee will consider such a request.

The hearing is being held while the parliament is sitting, so there may be divisions that occur from time to time that could interrupt the proceedings when senators or members have to leave, but I hope this will not unduly disrupt the hearing.

I welcome Ms Hambleton and Mr Crosby from the Australian Stock Exchange. We have before us your earlier written submissions and the additional submission you provided today. Are there any corrections or alterations that you wish to make to the submissions?

**Ms Hambleton**—No, thank you.

**CHAIR**—Do you wish to make an opening statement to the committee?

**Ms Hambleton**—Yes.

**CHAIR**—Please do so, and then we will proceed to questions.

**Ms Hambleton**—Thank you very much for having us here today. We are here because of concerns about investor protection in the wider sense of how the market operates and confidence that investors have in the market. We provided the submission to the committee earlier this month and have provided a supplementary submission today. I seek leave for the supplementary submission to be incorporated into the record.

**CHAIR**—Is it the wish of the committee that the document be incorporated in the transcript of evidence? There being no objection, it is so ordered.

*The document read as follows—*

**Ms Hambleton**—There are four issues that we want to discuss today: the circumstances in which investors can return securities; the use of funds raised under a prospectus before quotation; the issue of transfer of securities before quotation; and the way the CLERP provisions will make it harder for listed entities to make placements. I will deal with the first three issues, and Mr Crosby will deal with the issue of placements.

Before looking at it in detail, I want to make the point that we are sympathetic to the investor protection concerns that underlie the provisions that we have got problems with. What we say is that you need to balance these against investor confidence in the market and, when you do that, some of the investor protection concerns need to give way.

Looking at the first issue—the circumstances in which investors can return securities—the problem is that investors under the provisions are able to return securities within the first month after quotation. In a worst-case scenario, if sufficient investors do that, the entity may not be one that is suitable for listing, and we may have to suspend the securities and possibly remove the entity from the official list. This could be because of an insufficient spread or because of no longer having a business as a result of having to sell assets in order to return the funds to subscribers.

This results in differential treatment of what we have called, 'innocent investors'. You have the first class of investors who have the right to return the securities and get their subscriptions back if the company still has the money, and then there is the second class who have acquired the securities on market, and they do not have this right. We think that if the worst-case scenario were to happen, it would seriously damage investor confidence in the market that we operate.

Turning to the second problem, it is one that exists under the current law. We are not able to require an entity to use the funds to do what it says it will do in the prospectus before we grant unconditional permission for quotation. As a matter of practice, we do not actually quote the securities so that if something goes wrong, the securities are not traded. But the difficulty is that if something does go wrong and the business is not acquired and the entity does not proceed to quotation, subscribers under the prospectus have lost their statutory protection and the right to have their funds returned.

The final issue is that, under the current legislation, we can make the issue of transfer of securities a precondition of quotation. We will not be able to do this under the provisions in CLERP, and what we say again is that that lessens investor protection. Our understanding from discussions with Treasury is that the change was not a policy change but a consequence of drafting, and so we submit that that should be corrected.

The supplementary submission we provided today goes over the technical issues in more detail. It also raises some of the options that we have discussed with Treasury as a way of addressing some of these issues. That concludes what I have to say on the initial listings problem. Mr Crosby will deal with the placements.

**Mr Crosby**—Thank you, and I would like to repeat Deborah's thanks for the opportunity to appear today.

I thought it was best to start talking about placements to give you an idea of the size of the issue. Placements in calendar year 1998 raised over a third of the non-public offer initial public offering raisings in the Australian capital markets. It was over $2.7 billion of capital raised out of just shy of eight raised in issues by listed companies. There are a few issues of classification, and maybe not all of those placements are the sort that would be affected by the changes, but that is, broadly speaking, the parameters that we are talking about.

**Senator MURRAY**—How many are separate placements?

**Mr Crosby**—I do not have that data with me. I can find out for you, Senator, if you would like me to. It would be some thousands though.

**Senator MURRAY**—Thousands—thank you.

**Mr Crosby**—The point we want to make is that the CLERP bill, if it is enacted in its present form, will make those capital raisings—that raising of going on $3 billion—much more difficult. What that means is that if CLERP is enacted, then Australian businesses are going to find it harder to raise money to grow and to compete both domestically and internationally.

The obvious question that occurred to me, having thought through that framework, is why is it only the ASX making a fuss about it: why isn't everyone else jumping up and down. The answer to that is, I suspect, that others have not focused on the issue. We have been talking recently to the Securities Institute and they are now realising that there is an issue on foot and they have a committee meeting later this month to consider whether they will make a submission. They have told us that they are happy for us to inform the committee that they are looking at it seriously and that it is quite possible they will be turning up and making a submission.

The next question, I suppose, is how do the proposed changes make it harder. The new provisions are pretty complex and I spent a little bit of time trying to reduce it to a simple proposition. Basically, the effect is that there will be a presumption that a prospectus is needed if anyone who takes a placement, that is, who received shares as part of a private placement, offers those placement shares for sale within 12 months after they take the placement.

At the moment that is not a problem because the presumption does not apply if they offer the shares for sale through the stock market, through the seats trading system, and there are a few qualifications on that. But, basically, if they put them into the normal market, then that presumption does not arise. So that is a pretty dramatic change, especially for placements to professional investors.

The obvious response to the change, we feel, will be that institutions will insist on there being a prospectus before they take a placement. What that is going to do is make it slower and more expensive for companies to raise money because preparing a prospectus takes time, and the legal advice and those sorts of things that you need to put together a prospectus cost money.

The other change that I should mention is that there is a presumption in the present law that if the securities are not offered for sale through seats, which lasts for only six months after the issue, the new legislation will take that period to 12 months. In short, we think the upshot of the proposed changes is that a lot more placements will need prospectuses than presently is the case.

The question then is, given that we have identified pretty clearly what we see as a significant cost to the community from these changes, what is the justifying benefit when the benefit is supposed to be an increase in investor protection? We think that in all these things those issues should be balanced but, in looking at that balance in this case, you need to look at the full context. We think that when you do that the investor protection that will actually be added is not that great—is marginal—and therefore that the cost is difficult to justify. I will take you through how we see that argument working.

We are talking about companies that are listed and have been listed for some time, so there is already a body of disclosure and people are trading in the secondary market, and the regulatory regime allows them to trade. So the view must be that those people are making informed decisions and that the market has an information base on which people can make investment decisions.

Once there is a placement then that might expand the company's capital by up to 15 per cent. We have rules that effectively limit listed companies' capacity to issue capital to 15 per cent of their issued capital in any 12-month period; there will be continuous disclosure about the placement; there will be other disclosure of the details of the shares being issued; and there will be continuous disclosure about what the company is going to do with the money it is raising. You then have a situation after the placement where there are a whole lot of people who can buy shares, and people will continue to buy shares on the basis of an informed market from continuous disclosure and from whatever other disclosures there have been.

This regime must be aimed at investors in the secondary market because there is nothing to stop the company making the placement in the first place. It is only if the professional taking the placement is going to want to sell it that the prospectus provisions potentially kick in, and they must be aimed at providing that prospectus disclosure to the people who are going to buy the shares on a secondary basis. So they would be buying in the market potentially shares at the placement or, more likely, potentially shares held by people before the placement. There is a real question about where the additional information is flowing and for whose benefit.

If the issue is simply that the company is going to have significantly more capital, that can arise in all sorts of other ways. They can have options that come up for exercise and they can have a big inflow of capital from that sort of thing; they can have convertible securities. There are a whole lot of ways that companies can come into additional lots of money. If that is the issue, then it seems funny to focus on this, on a placement as the disclosure trigger.

The other way the argument is put is to say that it is not so much the enhancement of investor protection in this particular case; it is that there is an avoidance and there are ways

for people to avoid issuing prospectuses in circumstances that they otherwise would. That is true. What we are saying is that people undertake placements because it is the quickest, cheapest way to raise money. There are all sorts of other issues that would not make them want to do broader distributions if they could do them as quickly and cheaply otherwise but, as with many commercial decisions, they have to make those balances. The fact that it is an alternative to doing a prospectus does not necessarily justify imposing significant extra costs and effectively denying people that route, unless there is some damage being done by the avoidance or there is some damage to investor protection. What we are saying is that we are battling to identify where that damage is. That was basically what I wanted to say about placements.

I would like to wrap up, first of all in relation to the initial listing problems that Deborah talked about. Basically, what we are saying there is that there are two sorts of investor protection to be balanced. One is the protection of an individual investor in a particular issue, allowing them some right to get their money back if there is a colossal fraud or if they are terribly unlucky and the company's circumstances change at around the time of the fund raising. The thing you have to balance against that is investor protection in terms of the capacity of investors to have confidence in the whole market and the certainty of what is being offered in the whole market. What we are saying is that we are troubled that the proposed provisions get that balance wrong. In our assessment, the interests of the whole market should carry more weight than the interests of a particular narrow group of investors in a particular extreme set of circumstances and, frankly, in circumstances where it is pretty unlikely that there is going to be any money left for them to actually recover, given the way those sorts of disaster situations work out.

In relation to placements, what we are really saying is that we think it would be a rotten result for the Australian market if it is made harder for companies to raise money to grow their businesses. If there were real investor protection issues, then we would be in a different place. Investor protection is as important to us in defending our business franchise and providing the quality of our market as it is for any other group in the country, but we are saying that on close scrutiny and analysis the investor protection, as we see it, added by those proposed changes does not justify the costs that would be visited on business.

In our late submission—which I know you have not had the chance to read because you just got it when you sat down—we provide some technical suggestions which we have been working on that we think mitigate the problem if you are not prepared to go the whole hog and accept the broad propositions that we put. What we are saying is that in each area, in the initial listing area and in the placements area, you need to adopt what we have called in the submission the substantive remedies rather than the technical remedies.

**CHAIR**—Thank you. You say that you do not believe your proposals to modify the CLERP provisions will have any significant reduction on investor protection. You do not accept that the capacity for the Australian Securities and Investments Commission to give exemptions and make modifications is adequate to deal with the problem?

**Mr Crosby**—The obvious issue there is that placements are deals that are done very quickly. That is the reason they are attractive over other methods of raising capital. No matter how much good faith and efficiency the Securities and Investments Commission

brings to looking at waiver and modification applications—and they do a wonderful job dealing with those applications—it is still going to take a number of days for them to turn around the application. Placements tend to be done very quickly. It is a matter of getting investors. If investors are going to be committed for a period of days before they are certain that their transaction will proceed, then that obviously has costs for them. If they take securities, they are then in a position to manage their risk. The shorter the period of time the better, both for the issuer and for the person taking the placement.

**Ms Hambleton**—I will just add to that. The other issue is that ASIC is unlikely to address these sorts of issues by way of modification or exemption when an entire new regime has just been brought in that the government has considered, and these issues have been on the table. I think we would have great difficulty getting ASIC to do that. Potentially, they arise in every prospectus—the technical side of it.

**CHAIR**—So, you do not believe that the capacity of ASIC to provide either an exemption or a modification is adequate in relation to either the problem of placements or new listings?

**Ms Hambleton**—I do not think it is appropriate, either. If there is a problem with the legislation, it should be fixed in the legislation.

**Senator GIBSON**—What is your suggestion for change in relation to placements?

**Mr Crosby**—We propose that the exemption that has been deleted for resales through SEATS, so that the presumption does not arise in those circumstances, be reinstated.

**Ms Hambleton**—That is our primary submission. We also have some other options in the paper we discussed with Treasury, such as making it clear that the resale purpose is the primary purpose and not one of a number of purposes. Shortening the period of time in which there is a deemed presumption of resale from 12 months back to what is currently six months or even less—one month—along with a couple of other technical things, is really our secondary position.

**Mr Crosby**—They are really aimed at mitigating the problem rather than taking it away.

**Senator GIBSON**—Essentially you are recommending sweeping it away so as not to—

**Ms Hambleton**—Yes, putting it back to where it is now.

**CHAIR**—You had discussions with Treasury; did you have discussions with the minister?

**Ms Hambleton**—We have provided material to the minister and, from the most recent discussions with Treasury, I understand Treasury has put some proposals to the minister that the minister is considering.

**CHAIR**—In their discussion, has Treasury given any indication as to why they believe the proposed changes are superior to the existing regime which you want to see reinstated?

**Ms Hambleton**—It is primary investor protection concerns, which is why we wanted to make the distinction between the right of an individual investor to get money back, or whatever remedy, and confidence in the market. We are saying that we think that the individual investor's right should be subsumed with confidence in the market.

**CHAIR**—In fact, they are both relevant to investor protection—

**Ms Hambleton**—Absolutely.

**CHAIR**—and you need to have a balance between the two.

**Ms Hambleton**—We have acknowledged in our submissions and our discussions with Treasury that they are difficult issues, and what we have tried to do with Treasury is come up with some options that, to some extent, will address both concerns. But sometimes you have to make a choice.

**Ms JULIE BISHOP**—Following on that point: Mr Crosby, you said that a lot more placements would require prospectuses and that the investor protection would be marginal when we are looking at striking the right balance. Can you think of any reasonable circumstances where investor protection would be a more than marginal proposition, and by what measure do we determine what is marginal?

**Mr Crosby**—The circumstance that might not be marginal is where a company obtains shareholder approval to make a placement larger than the 15 per cent it is limited to without shareholder approval, and where the placement that it is considering is very significant in terms of the size of the company—100 per cent or 200 per cent of what they are at the moment. There is a whole range of scenarios in which that might happen, and in most of them we would be working hard for the continuous disclosure regime to make sure that the market was adequately informed in any case. But I think there is, at least in theory, a possible gap between where we could get to using that tool and where a prospectus might have you. That would be a very small minority of the number of placements that take place every day.

**Ms JULIE BISHOP**—Is it a circumstance you have come across?

**Mr Crosby**—Yes, it is a circumstance that happens. It would happen. I am uncomfortable guessing, but I guess there are some thousands of placements each year. I guess that there are perhaps 100 transactions like that each year. If the exemption was quarantined—to leave those transactions out—that would not trouble us.

**Ms JULIE BISHOP**—That is not an option you put forward.

**Mr Crosby**—No, it is not.

**Ms JULIE BISHOP**—Right.

**Mr Crosby**—As to your question of how you measure marginality, I am battling with that.

**Ms JULIE BISHOP**—I was just picking up your words. We were looking in your latest submission at finding the right balance. You said that investor protection would only be marginal, given the costs involved. I was trying to explore the issue of marginality.

**Ms Hambleton**—I think we have addressed this in the amendments we have talked about. If you are looking at an equity issuer and you are looking at securities in the same class as ordinary securities, why would someone who is taking up an issue of securities need additional information to what is already in the market and regarded as satisfactory for someone in a secondary market?

**Mr ROSS CAMERON**—I was really going down the same rabbit hole, if you like. If you look at the question of liquidity and of creating the circumstances under which individuals can generate wealth or have the maximum flexibility to structure their affairs, politically the burnt investor—especially in the case of large numbers of them in the same place at the same time—perhaps has an influence greater than they should. I suppose my question to you is similar to Ms Bishop's. Looking at, say, other jurisdictions around the world, do you think we try to mollycoddle the individual investor, and are we in an ultimately counterproductive search to create a level of security for the investor, who will always ultimately be taking decisions about commercial risk?

**Mr Crosby**—I think that is a very big question. There is a whole range of ways of skinning the market regulation cat. If you look at the way the Americans do it, in some ways they provide significantly more of the moral hazard sort of investor protection than we do. In other ways, they provide significantly less. It is very difficult to compare things that have arisen in completely different legal systems.

In our submissions here, I do not think we are saying, 'Let us take regulation in Australia off in a different direction.' We are saying, 'Let us work within the way and the paradigm in which it is done at the moment.' We are not suggesting that we become New Zealand, which is an example of somewhere that is much less interventionalist.

We are saying that, in the areas we have focused on here, even within the present paradigm you are not actually optimising the outcome. For instance, with the burnt investor, you are creating two classes when the float falls over: you have the people who took them under the float and who can get their money back, and you have the people who bought them in the secondary market and who are stuck with what they have. So even in a political dimension, you are not actually solving the problem but rather creating a whole raft of other problems.

**Mr ROSS CAMERON**—So you do not know the response to the chairman's question. You do not know why we are asking for this. You are asking the question, 'What is the up side, in terms of the investor?' You do not see where it is and you have not heard an explanation from anyone about where it is.

**Ms Hambleton**—No, Treasury has explained that its concern is that 1030(1A) creates the potential for avoidance. I think Mr Crosby is saying that it is a limited potential for avoidance.

**Mr SERCOMBE**—On the other side of the balance sheet, there is opportunity for someone to actually on-sell a placement to professional investors off market under the proposals of the Corporations Law.

**Ms Hambleton**—There is an exception for professional investors that would apply.

**Mr SERCOMBE**—How much does that exception or exemption narrow down the extent of the problem?

**Ms Hambleton**—It does not help at all if you are talking about selling on market.

**Mr SERCOMBE**—No, we are talking about selling off market. You cannot sell on market in this proposal, I understand.

**Mr Crosby**—The person that this creates a problem for is the person taking the placement, because they are effectively constrained as to how they deal, in ways that they are not at present.

**Mr SERCOMBE**—They are not so constrained they cannot sell their securities.

**Mr Crosby**—No, but they are constrained to finding someone themselves and not using the market, which, at the end of the day, is a search engine for buyers in that circumstance. They have to actually go and find someone themselves, and their choice of buyer is therefore dramatically smaller than it is at the moment. There is still a material downside for them.

**Senator MURRAY**—You have consulted with the Treasury and the Securities Institute. Have you consulted any investor representatives from the fund managers, the trustees or the shareholder representatives? Have you consulted anybody on the investor side as to what they think of your proposal?

**Mr Crosby**—We think that the Securities Institute has a broad constituency, and it certainly has a number of fund managers as members, but the short answer is that no, we have not consulted the Shareholders Association or the financial services association.

**Ms Hambleton**—These issues have been on the table for a number of years and we have been discussing them with Treasury. We spoke with the SIA to get some independent input and a feel for the proposals, but we did not really see it as our role to consult with a whole heap of organisations, which is what the CLERP process was about. It was about consultation.

**Senator MURRAY**—But your solution is a new one. These solutions have not been before us in this form before. If you do not consult those people, what has to happen is that we consult them. It would have helped if you had come here and said to us, 'Look. We have discussed this with a reasonable range of people from all sides of the picture and this is the consequence.' It would have been a short cut for us, quite frankly.

**Mr Crosby**—Your point is taken.

**Senator MURRAY**—The result of hearing what seems to be a reasonable proposition is that the only way for me to test it is now to present it to somebody who represents investors and see if they react favourably or not.

**Mr Crosby**—I do not want to disguise the fact that we have not consulted as you would like us to.

**Ms Hambleton**—It was not deliberate, in the sense that it was only in the past few days that we actually sorted out a number of the options.

**Mr Crosby**—What we are suggesting is not so much new solutions as old solutions, I suppose. As Deborah says, the issues have been on the table for some time. I suppose that is the thing that has led us not to think of going to those groups, as we may well have done if we were putting up something that we thought was novel and people had not seen it before.

**Senator MURRAY**—As Mr Cameron has rightly said to you, you would appreciate that the most prickly thing we always face with this kind of legislation is investor sensitivity, because of what has happened to groups of investors in the past.

**Mr Crosby**—We would say that is an area where all of our interests converge absolutely. Investor damage damages the confidence in the market we run just as much as it damages confidence in the regulatory regime in which you play such an important part.

**Senator MURRAY**—That is all I have, Mr Chairman.

**Senator COONEY**—You want to leave the legislation as it is now. As I understand it, when you went to Treasury, they said, 'It is protection that is behind this move.' Did they give you any examples or do you know of any examples—whether given by Treasury or not—where people would have been saved if the proposed amendment had been in operation?

**Mr Crosby**—Ms Hambleton will correct me if I am wrong, but I think that the return of securities provisions, for instance, at least in terms of listed companies, have not done any work since they were introduced. Is that right?

**Ms Hambleton**—I am not aware of them being used. They may have.

**Senator COONEY**—Treasury was not able to point to any examples—Sherlock Holmes style stuff such as 'The case of the missing investment' or anything like that?

**Ms Hambleton**—We did not raise that.

**Mr Crosby**—The discussions, at least the ones I was involved in, were theoretical rather than practical.

**Senator COONEY**—You do not know of any practical cases that this proposed amendment would cover.

**Ms Hambleton**—We do not; Treasury might. But the issue was not discussed, so we cannot really say if Treasury knows of any examples or not.

**Mr Crosby**—We do not.

**Mr SERCOMBE**—It is fairly unlikely that many people are going to own up to trying to avoid the prospectus provisions by acknowledging that that is what they are doing.

**CHAIR**—There are two other issues you have raised: the admission to quotation and the investment in main assets and floats. Are they not of as great concern as the two that we have discussed in some detail?

**Mr Crosby**—I suppose, because they relate to initial listings and initial public offerings, that we tend to talk about the return of securities and the two you mentioned in one breath. The same considerations apply to all of them.

**CHAIR**—If there are no further questions, on behalf of the committee, thank you, Mr Crosby and Ms Hambleton, for appearing before the committee this afternoon, the evidence you have presented and the answers you have given to our questions. They will certainly be taken into consideration in finalising our report on the legislation.

**Senator MURRAY**—Can I request, for the committee, that this proposal be sent to shareholder or investor bodies and that we ask them for their reaction?

**CHAIR**—Yes, I have no objection to that. I declare the hearing closed.

**Committee adjourned at 5.12 p.m.**