CONSULTATION PAPER 57

Buy-backs: Small parcels

December 2004

What this paper is about

1 We give case-by-case relief under the *Corporations Act 2001* (Act) so that a company can buy back a small parcel of shares from each shareholder (small parcel). We seek your comments on our proposed maximum value of a small parcel for these purposes. Our relief is from the requirement for the company to obtain a special resolution approving a selective buy-back: s257D. A buy-back of a small parcel is selective primarily because the small parcel represents a different percentage of the holding of each shareholder.

2 Usually the company buys back small parcels as part of a larger buy-back involving a scale-back mechanism. If a company wants to buy back a specific percentage or dollar value of its shares, and shareholders tender more than the amount the company wishes to buy, the company proportionately scales back the amount bought from each shareholder. The proportional scale-back of tendering shareholders generally occurs only after the company has bought back small parcels.

3 This document is not in ASIC's usual format for consulting on policy proposals (i.e. a policy proposal paper). This reflects the discrete and technical nature of these policy proposals.

4 We invite you to comment on the proposals, and on the questions we have included. Please provide us with any additional information (both qualitative and quantitative) to support any comments, issues or arguments you raise.

5 Submissions are due by **16 February 2005** and should be sent to:

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6 You can also contact ASIC Infoline on 1300 300 630 for information and assistance.

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Our proposals

Maximum value for threshold and residual parcels

7 We propose to set a maximum value of small parcels for our relief from the requirement to obtain a special resolution approving a buy-back, of:

(a) **$2000**, for shares to be bought back from each participating shareholder, including the entire holding of participating shareholders whose holding is less than $2000 (threshold parcel); plus

(b) **$500**, where a participating shareholder’s remaining shares are worth less than $500 after the threshold parcel is bought back (residual parcel).

8 In addition, we will impose conditions on our relief necessary to ensure that the buy-back is consistent with the principles of an equal access scheme, despite technically being a selective buy-back.

9 We propose $2000 for threshold parcels because this amount is sizeable enough to meaningfully reduce the number of shareholders and registry maintenance costs. It also corresponds with the spread requirements of Australian Stock Exchange Limited (ASX): see Listing Rule 1.1, condition 7.[1]

10 We propose up to $500 for residual parcels because this matches the amount in a ‘minimum holding buy-back’: s9 and 257B(1). A minimum holding buy-back is a buy-back of all holdings less than a marketable parcel (currently set at $500 for ASX-listed companies: see Procedure 2.1, ASX Market Rules). This addresses the risk that the company would actually be left with an increased number of small shareholders following the buy-back. A company could further reduce the number of small holdings following the buy-back of small parcels by repeating the process after 12 months.

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[1] ASX Listing Rule 1.1, condition 7 requires a company to have at least 500 shareholders each having a parcel of at least $2,000 in value. However, the rationale for the spread requirements is to ensure liquidity in the market for shares in a listed company, and is not directly related to the company costs incurred in maintaining a register with numerous small shareholders.

11 Our proposal for small parcels represents an appropriate balance between competing policy considerations:

(a) ensuring equality of opportunity to participate in a buy-back between shareholders; and

(b) enabling companies to reduce their registry maintenance costs by buying back small shareholdings for the benefit of all shareholders.

All shareholders would benefit from the reduced costs following the removal of large numbers of small shareholders.

12 This rationale is similar to that underlying minimum holding buy-backs, although in a minimum holding buy-back only those shareholders who hold less than a marketable parcel will receive buy-back offers. In a small parcel buy-back, all shareholders will have the opportunity to accept the buy-back offer.

Other options for threshold parcels

13 Other figures we have considered for the amount of threshold parcels include:

(a) **$5000**. This amount would be consistent with the maximum amount that ASIC permits to be raised from each shareholder under a share purchase plan: see Policy Statement 125 *Small offers of shares to existing shareholders by listed companies—share purchase plans* [PS 125]. However, [PS 125] does not consider equality of opportunity between different shareholders. It considers prospectus relief for small offers in view of the cost of preparing, printing and distributing a prospectus, shareholder access to new offers, and an informed market for the shares.

(b) **$500**. The main advantage of this option is that it is consistent with a minimum holding buy-back, which has a similar policy rationale to our relief for small parcels. However, $500 may be considered too small to allow for a meaningful reduction in the number of shareholders and registry maintenance costs.

(c) **A set number of securities**. For example, under United States (US) regulation, priority may only be given to holders of 100 securities or less (known as 'odd-lots'): Rule 13e-4(f)(3)(i) of the US Securities and Exchange Act of 1934. However, the value of a set number of shares may vary substantially from company to company. (Companies with US shareholders should consult with the SEC to ensure compliance with the US rules about buy-back offers).

Other options for residual parcels

14 Other amounts we have considered for the maximum amount of residual parcels include:

(a) **A parcel equivalent to the threshold parcel (e.g. $2000)**. This option would result in a greater reduction in small shareholders left on the register following the buy-back. Depending on the size of the threshold parcel, this option may result in buy-backs of larger parcels than are consistent with the underlying policy rationale.

(b) **Nil.** That is, a company can buy back only the threshold parcel before engaging in the scale-back. This option could potentially increase the number of small shareholders left on the register following the buy-back.

Your comments

Q1 Do you agree with the maximum amounts we propose to adopt for threshold parcels and residual parcels? If you favour one of the alternative options described, or a different approach, please describe why.

Q2 Would our proposed maximum amounts substantially reduce the number of holdings on the register?

Q3 Would our proposed maximum amounts increase the number of holdings?

Any information you can provide on how these amounts would affect the register of a particular company that has conducted or proposes to conduct a buy-back would be useful.

Explanations

Statutory provisions

15 Section 257B identifies five different types of buy-backs. The following three types of buy-backs are relevant to this consultation paper:

(a) **Equal access scheme.** This is a scheme that satisfies conditions designed to ensure that all shareholders are treated equally: s257B(2). These conditions are:

- (i) the offers under the scheme relate only to ordinary shares;
- (ii) the offers are to be made to every person who holds ordinary shares to buy back the same percentage of their ordinary shares;
- (iii) all of those persons have a reasonable opportunity to accept the offers made to them;
- (iv) buy-back agreements are not entered into until a specified time for acceptances of offers has closed; and
- (v) the terms of all the offers are the same.

(b) **Selective buy-back.** This is defined as a scheme which does not fall within any of the other four categories and generally involves a buy-back in which all shareholders are not being treated equally (s9); and

(c) **Minimum holding buy-back.** This is a buy-back of all of a holder's shares in a listed corporation if the shares are less than a marketable parcel within the rules of the relevant financial market.

16 An equal access scheme which is within the 10/12 limit described in s257B(4) does not require any shareholder approval: s257B(1). A selective buy-back requires approval by way of a special resolution, with no votes being cast in favour of the resolution by persons whose shares are to be bought back: s257D.

17 A buy-back of small parcels does not fall within the definition of an equal access scheme. The percentage of shares bought back is not equal for each shareholder: see paragraph 15(a)(ii) above. This is because small parcels constitute a fixed amount regardless of the size of a particular holding. Furthermore, small shareholders may be given priority to sell their residual parcels.

18 Small parcel buy-backs are often part of a buy-back involving a scale-back mechanism. Scale-backs are most often found in Dutch auction buy-backs.[2] A Dutch auction buy-back will require relief from the requirement of shareholder approval by special resolution for a selective buy-back, regardless of whether or not it involves a small parcel. Technically a Dutch auction will not fall within the terms of equal access scheme because the company does not 'offer' to buy shares but rather invites shareholders to offer to sell shares: see paragraph 15(a) above.

ASIC relief

19 Section 257D(4) empowers ASIC to grant an exemption from the requirement to obtain shareholder approval by special resolution for a selective buy-back.

20 ASIC has adopted Policy Statement 110 *Share buy-backs* [PS 110] which sets out, among other things, the circumstances in which ASIC will exercise its power to exempt a company from s257D for selective buy-back schemes.

21 Although it is not specifically addressed in the examples listed in Part IV of [PS 110], ASIC has on numerous occasions granted relief from s257D(1) (the requirement to obtain shareholder approval) for buy-backs that would be regarded as a selective buy-back only because they involved a small parcel or Dutch auction process. In our relief, we have imposed conditions to try to ensure that the buy-back is effectively an equal access scheme.

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[2] Under a Dutch auction buy-back, shareholders are invited to tender their shares for sale at a price nominated by the shareholder. The company then ascertains the lowest price at which it can buy back the desired number of shares.

Key terms

In this consultation paper:

ASIC means the Australian Securities and Investments Commission

ASX means the Australian Stock Exchange Limited

Corporations Act means the *Corporations Act 2001* and includes regulations made for the purposes of the Act

residual parcel means the value of a participating shareholder's remaining shares where that value is less than a specified amount after the threshold parcel is bought back

s257B (for example) means a section of the Corporations Act (in this example numbered 257B)

scale-back means a proportionate reduction in the number of shares bought from each shareholder in a buy-back

small parcel means the combination of a buy-back's threshold parcel and residual parcel

threshold parcel means the value of a fixed number of shares to be bought back from each participating shareholding in a buy-back (including the entire holding of participating shareholders whose holding is less than that value)