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Kim Demarte
Senior Specialist—Mergers & Acquisitions Corporations
Australian Securities and Investments Commission
Level 7, 120 Collins Street, Melbourne, VIC, 3000

Email: stub.equity@asic.gov.au

Dear Mr Demarte

ASA SUBMISSION – STUB EQUITY IN CONTROL TRANSACTIONS: CONSULTATION PAPER

The Australian Shareholders' Association (ASA) represents its members to promote and safeguard their interests in the Australian equity capital markets. The ASA is an independent not-for-profit organisation funded by and operating in the interests of its members, primarily individual and retail investors and self-managed superannuation fund (SMSF) trustees. ASA also represents those investors and shareholders who are not members, but follow the ASA through various means, as our relevance extends to the broader investor community.

ASA will not respond to all aspects of the consultation paper 312, *Stub equity in control transactions* dated June 2019 (the paper), but supports the proposals in the paper, given its particular relevance to our members. We comment on the risks to retail shareholders that have been publicly stated by industry participants.

We are supportive of the move to improve the controls around transactions where the consideration offered includes stub equity in proprietary companies or other issuers where certain investors are required to hold that scrip through custody arrangements. Legislation and protections for retail shareholders recognise the range of financial literacy exhibited by individual investors as well as the time constraints they experience. Investing is not a full-time occupation for retail shareholders and reviewing scheme booklets may not easily be accommodated in otherwise busy lives. Stub equity sidesteps these protections.

The paper at 29c lists "limit the ability or circumstances in which a holder may dispose of their securities" as a feature of stub equity.We highlight, as reported in the 2017 ASX Investor Study, that over 30 per cent of all investors list saving for a rainy day as one of their top investment goals, unsurprising given the liquidity of listed shares. Ranking ahead of rainy-day investing, in excess of 50 per cent of investors listed in the same study planning for retirement and accumulating wealth as their top investment goals. We consider it is difficult to convey the degree of illiquidity of unlisted investments to investors who predominantly invest in ASX-listed shares. Any arrangement that limits the ability or circumstances in which a holder may dispose of their securities clearly disadvantages retail investors where there is a lack of clarity as to the illiquidity of their investment.

ASA recognises that takeovers are a feature of investing in shares and discouraging takeovers would be negative. However, it is a matter of fairness that retail investors are adequately compensated for providing capital to companies and for the reinvestment risk crystallised by scheme transactions.

We are comfortable with the proposal in the paper that will result in delivering at least two classes of shareholders in a scheme; namely those entities and individuals such as larger private, professional, sophisticated and institutional shareholders able to hold illiquid investments under their mandates and retail investors. The size of the holdings of the former class justify and support their access to investment, legal and accounting resources which are suited to monitoring and influencing unlisted investments. This resourcing and influence is far beyond the scope of an individual retail investor.

Industry participants responding to this paper have held out there is no issue with offers including a stub equity component, because retail shareholders tend not to accept the stub equity alternatives when accepting an offer. Illustrative of a number of the arguments, a recent *Australian Financial Review* article, *ASIC's overkill on 'stub equity' in private deals*[1] lists the Healthscope scheme[2] as an example of a successful bid which included a stub equity offering with tepid uptake by shareholders. The implication is that retail shareholders are knowledgeable enough to reject stub equity if it doesn't meet their investment goals or requirements, and therefore no protection is required.

However, it should be noted that Healthscope Chair Paula Dwyer's opening letter to shareholders conveyed the directors' recommendation to accept the cash offer and devoted half a page to emphasising the risks of accepting the stub equity. In addition, despite the independent expert concluding that the transaction was fair and reasonable and therefore the scheme was in the best interests of Healthscope shareholders in the absence of a superior proposal, at page five of the transaction booklet, a footnote states that, had the independent expert been required to provide an opinion on a scrip only transaction (that is with no cash alternative), it is likely it would have concluded that the transaction was not fair. These disclosures indicate that the stub equity was not an appropriate option for shareholders, making stub equity a Hobson's choice. ASA is strongly of the view that it is not appropriate for the fairness of a transaction to rely on the disclosures of directors and independent experts who may have a limited brief and at times the Court on making this non-choice apparent. Regulation appears to be the appropriate remedy, as industry practice does not appear to acknowledge that, for retail investors, this apparent free choice involves either taking it or taking nothing — in other words, a non-choice.

Further the article referenced above states: "It is a feature of Australian schemes that stub equity is offered to all shareholders to avoid class issues." This is taken to mean that if the shareholders for whom the stub equity is a critical part of accepting the scheme were excluded from the aggregate total shareholders, the cash offer would not be sufficiently attractive for advisers to the transaction to be confident the cash-only recipients would vote in favour in sufficient numbers. If the offer is not sufficiently attractive to attract a "for" vote by a class of investors, combining the classes overrules the impact of any dissatisfaction. The non-choice renders the combination of classes of investors inappropriate.

The article also notes: "Somewhat ironically, if ASIC gets its way to 'look through' the custodian position, sponsors may well be forced to revert to using foreign holding vehicles not otherwise subject to ASIC's purview". Given the home-bias behaviour that is particularly evident amongst retail investors, this would be preferable to offering Australian unlisted untradeable equity. The nature of foreign or tax-haven domiciled

[1] Mark McNamara, Lee Horan, Mark Vanderneut and Cathy Chan, June 24, 2019
[2] Healthscope Transaction Booklet 16 April,2019

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scrip is that it acts on an investor's home-market bias, flagging an issue to the investor who has received voluminous documents where many aspects of the scheme are covered.

In summary, we see the offer of stub equity as a non-choice for retail investors, which leads to an artificial collapsing of the class of investors in order to secure approval of a takeover by scheme.

If you have any questions about this submission, please do not hesitate to contact me, or Fiona Balzer, Policy & Advocacy Manager on or at .

Yours sincerely

Judith Fox
Chief Executive Officer
Australian Shareholders' Association