

24 July 2019

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

By email: stubb.equity@asic.gov.au

Re: ASIC Consultation Paper 312 – Stubb equity in control transactions

Dear Mr Demarte,

The Australian Investment Council welcomes the opportunity to contribute our feedback in response to ASIC Consultation Paper 312 (the consultation paper) and ASIC's proposal to address concerns about certain offers of stub equity scrip considerations in control transactions, released in June 2019.

The Australian Investment Council is the voice of private capital in Australia. Private capital investment has played a central role in the growth and expansion of thousands of businesses, which when combined represents a multi-billion dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include: private equity, venture capital and private credit funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers.

Private capital fund managers such as private equity firms invest billions of dollars into Australian companies every year. For example, \$12.5b worth of private equity-backed deals were undertaken in Australia over the 2018 calendar year alone. The private capital industry is a key participant in Australia's M&A market; in FY2016, for example, private equity-backed transactions accounted for 20% of the total value of Australia's M&A transactions. Our industry has a particular interest in this issue given the broad use of control transactions by private capital funds.

The Australian Investment Council recognises the concerns that ASIC has raised with respect to the use of stub equity in unlisted vehicles such as proprietary companies. However, the use of stub equity in deals is commercially sensible in some circumstances, such as enabling key target shareholders or existing management to remain invested in the business, and shouldn't *per se* be seen as an undesirable practice.

Furthermore, we understand that the take-up of these offers by shareholders in the listed market has been immaterial, and thus we believe that they shouldn't warrant a wholesale change to existing rules and provisions of corporations law.

We also believe that effecting ASIC's proposed changes to the use of stub equity – in effect prohibiting control transactions with stub equity features – would have a negative impact on important features of the Australian M&A market, corporate law framework, and investment activity.

We believe that introducing the proposed changes would result in the following negative impacts:

- Reducing investor flexibility and optionality
- Encouraging the use of offshore structures
- Affecting Australia's ability to attract inbound investment

More detailed feedback on the proposals in the consultation paper are further outlined below.



Ultimately, the negative impacts that we believe would come as a result of ASIC's proposed changes would affect the attractiveness of Australia as a destination for offshore capital investment. At a time when the Australian economy is facing a number of challenges and headwinds, setting up rules which deter investment – a key driver of economic and jobs growth – is risky and should be carefully considered.

We look forward to participating in any future discussions about the issues set out in this submission. If you would like to discuss further, please do not hesitate to contact either me or Kosta Sinelnikov, the Australian Investment Council's Head of Policy & Research, on 02 8243 7000.

Yours sincerely,

Yasser El-Ansary
Chief Executive



Responses to consultation paper proposals

1. Reducing investor flexibility and optionality

Control transactions with offers of stub equity are generally undertaken in the listed market by private entities seeking to acquire public companies. The consultation paper proposes to eliminate existing exemptions from certain rules and obligations when such control transactions are undertaken.

One of our primary concerns with ASIC's proposed changes is that they will reduce the flexibility of shareholders of public companies subject to control transactions to be able to choose whether they would prefer to take the offer of cash or scrip. We believe that the ability to provide flexibility and optionality to retail shareholders of retaining an ownership stake in a business that is soon to become private is a valuable feature of Australia's investment landscape.

Australia has a robust and well-functioning legal and regulatory framework which already offers retail investors significant protections through various pieces of legislation, the oversight of regulators such as ASIC, APRA and the RBA, and market-specific regulations such as those enforced by the ASX on ASX-listed companies and market participants. Introducing further regulations in the form of the proposed changes would only serve to constrain M&A and investment activity. It would also close off the opportunity for retail investors – which are well-protected under existing rules – to retain a stake in companies that are targeted for control transactions and stand to benefit from the value-creating process undertaken by private capital investors (i.e. the bidders in many of these scenarios).

Private capital investors, particularly professional fund managers that manage capital on behalf of institutional investors, acquire ownership stakes in companies with a view to increasing the value of those businesses over the medium and long-term. This is done through a variety of ways, and a private capital investor will most often look for and make investments with these value-adding opportunities in mind. The most common value-add strategies include operational improvements, investing in productive capacity and R&D, management changes, funding company growth through organic means or through acquisition, improvements to governance structures, and implementing the efficient use of capital.

Undertaking such value-adding strategies can be a fraught process for companies listed on public markets because of the increased exposure as well as reporting and disclosure regulations that must be adhered to. As such, the offer of exposure to proprietary or unlisted public companies backed by sophisticated private capital managers can present an exceptional opportunity for retail investors. Closing off that opportunity would negatively impact on investor choice and market efficiency.

2. Encouraging the use of offshore structures

From our understanding of the issue, there has been a tendency for bidders in these situations to use Australian-domiciled companies through which stub equity components of the transaction are offered. Another feature of such deals is the use of professional custodians to hold any stub equity issued under the bid.

We believe that the proposed change to effectively eliminate offers of stub equity through Australian proprietary or unlisted public companies will encourage bidders to use offshore structures to achieve similar outcomes. Such an outcome would reduce the ability of ASIC and other regulators such as the ATO to monitor those companies and entities both during and after the completion of transactions. It would also see Australian investors lose some of the protections that they may be afforded as shareholders of Australian-domiciled companies if bidders decide to structure through offshore entities.



3. Australia as a net importer of capital

It is important for regulators and policy-makers to recognise the reliance that Australia has on offshore capital, particularly in meeting the financing needs of Australian businesses. This has been previously noted by the 2014 Financial System Inquiry and the earlier Johnson Report (“Australia as a Financial Centre”), which highlighted that Australia’s historic reliance on foreign capital is likely to remain the case for decades to come. Any regulatory hurdles that diminish Australia’s ability to attract inbound investment will have a negative impact on the companies and businesses that rely on that investment.

Australia competes globally for capital against other well-regulated market economies in the region such as Singapore, South Korea, and Japan, as well as the larger economies of Europe and North America, in part on the strength of our existing corporations law framework. As a result, Australian jobs and industry rely on a steady inflow of foreign capital to support investment into growing businesses across all sectors of the economy. We believe that encouraging more investment, especially at a time of domestic and global economic challenges, should be a key priority considered by policy-makers and regulatory agencies.

Australia’s standing as an open market and economy should thus be taken into consideration when assessing regulatory issues and changes to corporations law. We would urge ASIC to include this element in the thinking currently being done on this issue of stub equity in control transactions.