AFMA

27 May 2022

ASX Limited
PO Box H224
Australia Square NSW 1215

Attention: Kevin Lewis

By email: kevin.lewis@asx.com.au

Dear Mr Lewis

Proposed enhancements to the ASX Listing Rules

We refer to ASX Limited's (**ASX**) public consultation paper dated 5 April 2022 on proposed enhancements to the ASX Listing Rules: Continually improving the reputation and integrity of the ASX market (**Consultation Paper**).

The Australian Financial Markets Association (**AFMA**) welcomes the opportunity to comment on the proposed changes to the ASX Listing Rules outlined in the Consultation Paper.

In summary, AFMA is very concerned that the proposed constraints on allocation policies of Issuers on pro rata issues and the additional upfront disclosure obligations regarding allocations in material placements are not market enhancing and would detract - in a significant and adverse respect - from efficient equity capital markets. AFMA is of the view that the current regime provides the appropriate balance between fairness in allowing existing security holders to participate in equity raisings while also providing an appropriate degree of flexibility to allocate pro rata offer shortfalls and material placements to existing and new investors in a way which is in the best interests of the entity raising the equity capital (***Issuer***).

We believe that the proposed changes would be detrimental to an Issuer's ability to raise equity capital. The changes would likely increase the cost of capital and impose an unnecessary constraint on Issuers to respond to an evolving and dynamic operating environment. The capital raising structures that are currently permitted under the ASX Listing Rules and *Corporations Act 2001* (Cth) have served Australia's capital markets and business needs well, including through challenging times. AFMA believes the proposed changes are not needed and is concerned about the implications for Australia's equity capital markets.

AFMA sets out its detailed comments on the proposals and questions posed in the consultation paper as follows.

CP Section 2.1.1: Security purchase plan – Scale-backs

Under previous 2020 temporary relief f or a capital raising that had a security purchase plan (***SPP***) component, there was the requirement that the entity had to disclose the scale-back arrangements to be applied in the event the SPP offer was over-subscribed. The scale back arrangements could include measures to prevent security holders splitting holdings to obtain a larger offer under the SPP but otherwise had to be applied on a pro rata basis to all participants, based either on the size of their existing security holdings or on the number of securities they had applied for.

ASX is proposing to impose a similar requirement on exception 5 in rule 7.24, and also on exception 4 in rule 10.12.5

Rule 7.2 sets out exceptions to Rule 7.1. Broadly speaking, rule 7.1 requires listed entities to obtain security holder approval if they issue securities comprising more than 15% of their ordinary share capital within any 12-month period (commonly referred to as the "15% placement limit"). Exception 5 of rule 7.2 excludes from the 15% placement limit securities issued under an SPP that meets the conditions set out in that exception. Exception 4 to rule 10.11 does the same thing.

The changes are not required

AFMA supports the ASX's focus on seeking to ensure that SPPs are not "gamed", including through the use of nominal or split holdings to receive better allocations. In this respect, AFMA is supportive of a general statement concerning nominal and split holdings but is of the view that this should be provided by way of guidance only.

AFMA believes that the changes to the ASX Listing Rules are not required. In particular, we are concerned that the proposed changes will unduly limit an Issuer's flexibility to raise capital through a SPP. In terms of ASX's concerns about "gaming" of SPPs, AFMA believes that directors' duties already provide sufficient guardrails to ensure that this issue is addressed.

Important to maintain flexibility

AFMA believes that it is important to give Issuers and their directors the discretion to structure SPPs in a way that they determine is in the best interests of the Issuer, having regard to not only fairness considerations, but among other matters, the amount to be raised under the SPP, as well as the use of proceeds. Accordingly, AFMA is of the view that, if ASX decides to pursue these changes (which we do not support), ASX should allow the directors to adopt a flexible approach to scale-backs. This would entail building greater flexibility into the mechanisms proposed.

Based on the current drafting, the scale-back mechanisms are listed as separate alternatives. AFMA believes that neither alternative is appropriate, and at the very least, directors should have the flexibility to scale-back using a combination of approaches. The example provided by ASX in the last paragraph of section 2.1.1 of the consultation recognises that such a combination may be warranted.

Furthermore, from an Issuer perspective, the introduction of a scale-back regime which allows for scale-backs solely based upon the number of securities applied for under an SPP (as is contemplated in the draft rules) does not seem sensible and will likely lead to certain securityholders lodging applications for participation well in excess of a reasonable quantum relative to their existing investment, in an attempt to take advantage of the SPP pricing, only to then sell into the after-market. This will likely not result in a positive outcome for the Issuer as securities under the offer are placed with shareholders who do not have commercial alignment with an Issuer with regards to long term stable shareholder register. Accordingly, if ASX was minded to force directors to choose between an approach that is based on applications or holdings on the applicable record date, then the basis for conducting a scale-back on an SPP is better based on a pro rata to the size of a person's security holdings on the record date for the SPP offer (or an earlier date selected by the entity).

No need for alternative approaches

AFMA believes that there is no requirement for prescriptive scale-back mechanisms for SPPs. Nor does AFMA consider that a prescriptive scale-back mechanism to tackle the issue of "gaming" of SPPs is appropriate. AFMA reiterates the need to ensure that directors retain appropriate flexibility to structure SPPs in a way that best serves the interests of the Issuer.

CP Section 2.1.2: Pro rata Issues (exception 3 in ASX Listing Rule 7.2)

Changes to exception 3 in rule 7.2, which provides an exception from the 15% placement limit in rule 7.1 for the allocation of any shortfall under a pro rata issue that meets the conditions set out in that exception. In relation to pro rata issues ASX proposes to make the same changes to rule 7.2 as are proposed for exception 5 for SPPs.

AFMA does not support this proposal. The proposed changes to exception 3 in rule 7.2 to the effect that pro rata entitlement offers will not qualify for the exception unless the shortfall is allocated to existing security holders will, in AFMA's view, have major negative consequences for the efficiency (and cost) of pro rata issues in Australia.

Rules 7.1, 7.1A and 7.2 are intended to give effect to the principle that securities should be issued in circumstances, and have the rights and obligations attaching to them, that are fair to new and existing security holders.[1]

Pro rata issues are excluded from the restrictions in rule 7.1 as all securityholders have an opportunity to participate in the issue and to maintain their proportionate equity interest in the entity.[2]

Directors must act in the best interests of the Issuer in making fund raising decisions. In addition to fairness considerations for new and existing securityholders, relevant legitimate objectives that boards must consider beyond just raising funds include adding new long-term institutional investors to the register to provide or increase liquidity,

[1] Guidance Note 21, paragraph 1
[2] Guidance Note 21, paragraph 4.2

broadening the investor base and maximising the price at which securities are issued and the strategic benefits of allocating securities to long-term investors who understand the business or to investors who are (or are likely to become) customers of the Issuer or for other strategic reasons.

This has long been facilitated under exception 3 in rule 7.2 so that a balance has been struck between not unfairly diluting existing securityholders whilst also allowing boards to exercise discretion in the best interests of the Issuer to achieve all of the objectives of the fund raising..

Issuers, with the benefit of expert advice from their corporate advisors (including the provision of allocation recommendations), have had the flexibility to allocate the shortfall to the most appropriate investors to achieve the most beneficial outcome for the Issuer (and all securityholders), having regard to the Issuer's objectives. Corporate advisors, as Australian Financial Services licensees, are subject to certain obligations including the obligation to provide efficient, honest and fair financial services, and in delivering expert advice (and recommendations) to Issuers, are cognisant of such obligations and of ASIC's recommendation that an Issuer's objectives are to be the primary consideration of a licensee when making any allocation recommendations.[3]

The changes proposed by ASX unreasonably fetter the ability of boards to allocate shortfalls under pro rata issues in a way which hinders them being able to act in the best interests of the Issuer.

A board who determines to proceed by way of a pro rata offer should therefore retain the flexibility of being able to allocate shortfall securities in its discretion to a mix of existing securityholders and new investors which the board considers will best serve the Issuer in the longer term and create a strong aftermarket in the securities.

An additional concern regarding the proposed prescribed allocation regime is the impact it will have on the availability of sub-underwriting for pro rata issues and, as a result, the ability of an underwriter to manage its risk and the likely cost of the capital raising. Sub-underwriting plays an important role in an underwritten pro rata offer, as it enables more favourable pricing (i.e. a smaller discount) for the pro rata offer and reduces the costs of the capital raising for Issuers. AFMA anticipates that the proposed changes will make it more difficult for underwriters and sub-underwriters to make predictions in respect of the "natural shortfall" at the time sub-underwriting commitments are sought by an underwriter. We anticipate that this will make it more difficult and / or costly for the underwriter to attract an appropriate level demand from sub-underwriters to manage its risk and in turn will likely increase the cost of underwriting, and will significantly and adversely impact the ability of Issuers to undertake underwritten pro rata issues.

This may ultimately have the unintended consequence that there will be fewer pro rata issues undertaken by Issuers, with Issuers instead seeking to raise capital under alternative structures which may be more dilutive to existing securityholders. In addition, ASX's proposed changes are likely unworkable as a practical matter in the context of accelerated pro rata issues and renounceable pro rata issues.

[3] ASIC Report 605, C1.

In an accelerated pro rata issue, as ASX appreciates, there are effectively 2 shortfalls – the shortfall under the institutional entitlement offer and the shortfall under the retail entitlement offer, which means that allocations of the institutional shortfall and the retail shortfall are made at different times. Allocations of the shortfall under the institutional entitlement offer are made before the total shortfall is known or the interest of securityholders in taking up securities in excess of their entitlement is known. Given the structure of an accelerated pro rata offer it is not therefore possible to comply with the requirements of the proposed new exception 3 in rule 7.2.

In the context of a renounceable pro rata issue it is also difficult to see how the rights of a securityholder to deal with its entitlement if the securityholder does not wish to take it up (including by selling it on market) can sit with a requirement that securityholders have a priority right to be allocated the shortfall.

The basis on which ASX proposes that the shortfall be allocated to existing securityholders is also not appropriate. Allocations based upon the number of securities a securityholder has applied for in excess of their entitlement will result in securityholders making inappropriate applications well in excess of their pro rata allocation solely for the purpose of maximising their potential allocation of shortfall stock. In these circumstances a securityholder that the Issuer and the lead manager or joint lead managers know should not be allocated an inflated quantum of stock (e.g. relative to fund size) can create an unnecessary risk to aftermarket performance.

ASX's concern that there are limited "inappropriate practices" with respect to allocation of shortfalls should be addressed by ASX issuing more specific guidance on this matter and directly approaching Issuers engaging in such practices, not through the introduction of an inflexible market-wide allocation regime that will have second order negative impacts.

CP Section 2.1.2: Material Placements

New disclosure requirements proposed in rule 7.10 for material placements by way of a non-pro rata offer mentioned in section 2.1.3 above, including the appropriateness of the thresholds for the application of that rule that the offer: (a) comprise more than 10% of the number of ordinary securities the entity has on issue at the commencement of the offer, or (b) is for an aggregate issue price of more than $50 million (whichever is the lesser).

AFMA does not support the proposed changes to the ASX Listing Rules regarding 'material' placements.

The enhanced disclosure requirements concerning allocations that were a condition of ASX's COVID-19 emergency capital raising relief applied in the context of Issuers who wished to raise capital in excess of their 15% placement capacity (i.e. up to 25%). The enhanced disclosure requirements were imposed because of the increased risk of dilution of existing securityholders. That rationale does not exist in normal circumstances.

Further the proposed amendments go further than what was required under ASX's COVID-19 emergency capital raising relief in that they require Issuers to disclose in the documentation for the offer whether existing holders will be entitled to participate in the offer and, if so, on what basis.

Fundamentally, Issuers and their advisors, require flexibility regarding the allocation of securities in placements to achieve the best allocation outcomes to a mix of both existing and new investors. Issuers should not be required to disclose upon initial announcement of a placement whether existing holders will be entitled to participate and, if so, on what basis. The very nature of a placement means that no securityholder is entitled to participate (unlike a pro rata issue). When Issuers make a placement they need flexibility to achieve allocation outcomes which best suit the interests of the Issuer and meet the objectives of the placement other than raising capital. How allocations are made is very much influenced by demand for securities in the placement which is not understood until after the placement has launched. The circumstances of the transaction which exist prior to launch often change during execution, and Issuers need flexibility to adapt and make allocations which are in their best interests.

It is unhelpful for Issuers attempting to raise capital in an efficient manner, in a competitive environment and at the best possible pricing to be required to disclose whether existing securityholders are entitled to participate in a placement and, if so, on what basis before the Issuer is able to fully understand what allocation outcomes in the context of available demand best serve the Issuer. Further, prescribing upfront the entitlement of existing securityholders to participate in a placement may be problematic for Issuers who wish to have the placement underwritten as any fetter on how allocations are made under the placement increases underwriting risk (and therefore underwriting fees). It will also be problematic if securityholders who wish to participate in the placement do not meet any on-boarding or required credit approval requirements of the underwriter.

Issuers already take into account participation by those of its existing security holders who are eligible to participate in placements as they seek to act in the best interests of securityholders. Ultimately, the Board is accountable to its existing securityholders.

It is market practice for existing eligible securityholders that bid for securities in a placement to be allocated to a minimum of their pro rata, should they bid for this quantum of stock. In our experience, Issuers commonly allocate securities to existing securityholders in excess of their pro rata if that is in the best interests of the Issuer and the success of the placement, taking into account multiple factors such as overall demand, past investor behaviour, bid size relative to the size of the placement and the timing of the bid in the process.

The current practice of Issuers disclosing general information regarding the allocation of placements post offering, together with substantial holder notices, provides a level of detail to the market required by investors.

If the additional disclosure requirements are implemented, AFMA submits that the trigger proposed by ASX for determining which placements will be material placements is inappropriate. Given the range of market capitalisations of ASX listed companies to set a trigger at the lesser of 10% of securities on issue and $50 million will result in $50 million raisings by Issuers with significant market capitalisations being treated as material which is clearly inappropriate given the relative size of the placement and the minimal dilutive impact. AFMA submits that an appropriate trigger would be simply if the placement comprises more than 10% of the number of ordinary securities the entity has on issue at the commencement of the placement.

As previously indicated, AFMA is not in favour of the proposed requirement for Issuers to provide ASX, on ASX's request, with detailed allocation spreadsheets. The basis of allocation outcomes determined by Issuers is commercially sensitive information to both the Issuer and investing securityholders and new investors. If there are circumstances where certain securityholders feel aggrieved by an allocation outcome under a particular placement then they should approach ASIC to use its powers under the Corporations Act to seek relevant information and to take appropriate action against the Issuer. Nevertheless, AFMA welcomes that such information will only need to be provided on the request of ASX and not for every material placement.

CP Section 2.3: Admission and quotation requirements

Concerns with the current versions of rule 10.18 and 10.19 and also on whether they support the amendments that ASX is proposing to rule 10.18.

AFMA understands the need to properly evaluate spread requirements and does not object to the proposal.

AFMA does, however, recommend that ASX also include New Zealand as a default jurisdiction given that, in the view of AFMA members, it is relatively customary to extend an IPO to retail and institutional investors in that jurisdiction.

Requiring the spread to be sourced only from Australia residential investors or from another jurisdiction acceptable to ASX also raises the question about what is an 'acceptable jurisdiction'? Certainty is desirable in this regard and ASX is asked to clearly state what is an acceptable jurisdiction.

Other sections

AFMA has no other comments to make on Sections 2.2 to 2.6 of the proposed changes.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au in regard to this letter.

Yours sincerely

David Love
General Counsel & International Adviser