

CONSULTATION PAPER 91

Non-traditional rights issues

September 2007

About this paper

Recent amendments to the *Corporations Act 2001* (Cth) (Corporations Act) provide an exemption from the requirement to issue a prospectus or PDS for rights issues. Some offers using a non-traditional rights issue structure, including accelerated rights issues, fall outside this exemption. In an accelerated rights issue, the offer to institutional holders is accelerated to enable issuers to raise funds more quickly and to give greater certainty about the funds that will be raised.

This paper seeks your feedback on some specific circumstances where it might be appropriate for us to give relief to allow non-traditional rights issues to use the disclosure exemption.

About ASIC regulatory documents

In administering legislation, ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 28 September 2007 and is based on the Corporations Act as at 28 September 2007.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

The consultation process

You are invited to comment on the issues raised in this paper. Any proposals we raise in this paper are only an indication of the approach we might take and are not our final policy.

As well as responding to the specific feedback questions, we are also keen to hear from you on any other related issues you consider important.

We are keen to fully understand and assess the financial and other impacts of proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information.

Your comments will help us develop our policy on issues arising out of the disclosure exemption that affects non-traditional rights issues. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits, will be taken into account if we prepare a Business Cost Calculator Report and/or a Regulation Impact Statement: see Section C Regulatory and financial impact, p. 14.

Making a submission

We will not treat your submission as confidential unless you specifically ask that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 7 November 2007 to:

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 Regulatory Policy
 Australian Securities and Investments Commission
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What will happen next?

Stage 1	28 September 2007	ASIC consultation paper released.
Stage 2	7 November 2007	Comments due on the consultation paper.
Stage 3		ASIC will consider whether relief is required and in what form.

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A Disclosure exemption for rights issues

Key points

Amendments to the Corporations Act introduced on 28 June 2007 provide an exemption from the requirement to provide a prospectus or PDS for 'rights issues' of quoted securities and quoted interests (the **disclosure exemption**) to encourage this kind of fundraising in which retail holders can participate as opposed to forms of fundraising that exclude retail holders (e.g. institutional placements).

The underlying rationale of conditions imposed on what will be a 'rights issue' for the purpose of the disclosure exemption is that a rights issue must give holders an equal opportunity to participate (the **equality principle**). Where features of a non-traditional rights issue do not offend the spirit of the equal opportunity principle, issuers should be allowed to use the disclosure exemption.

Without ASIC relief, non-traditional rights issues might not qualify for the disclosure exemption because there are various minor inequalities involved (e.g. timing) and so the 'equality principle' is not strictly met.

Underlying rationale

- 1 The *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007* (the **SRS Act**) amended the Corporations Act to allow listed entities to raise funds under a rights issue without a prospectus or PDS. The disclosure exemption is limited to quoted securities or interests because continuous disclosure facilitates informed decisions on the rights issue by holders. The disclosure exemption was intended to benefit retail holders by encouraging listed entities to make greater use of rights issues, rather than other forms of fundraising that exclude retail holders and do not require a prospectus (such as institutional placements).
- 2 The disclosure exemption applies to a rights issue defined in s9A—that is, an offer to existing security holders in a class in proportion to their holdings in that class on the same terms (i.e. a 'pro rata' offer). The purpose of this condition was to confine the exemption so that it only applied to an offer where holders have an equal opportunity to participate.

Effect of the changes

3

Table 1 summarises:

- (a) the conditions that a rights issue must satisfy under s9A for the disclosure exemption to apply;
- (b) the requirement under s708AA(2)(f) (for securities) and 1012DAA(2)(f) (for interests) for the issuer to give the market operator a cleansing notice that replaces the disclosure that would otherwise be required in a prospectus or PDS; and
- (b) other requirements that would apply to these issues, including under the on-sale provisions.

Table 1: How the disclosure exemption applies

Offer to all existing holders in a class	The offer must be made to all existing holders in a particular class: s9A.
Pro rata offer	The offer must be of quoted securities or interests and made to existing holders in proportion to their holdings (subject to certain exceptions for holders outside Australia and New Zealand): s9A.
Terms of offer	The terms of the offer must be the same: s9A.
Rights issue cleansing notice	The issuer must give the market operator a cleansing notice containing certain prescribed information in the 24-hour period before the offers are made: s708AA(2)(f) and s1012DAA(2)(f).
Other requirements	The offer must comply with certain other requirements, including restrictions on suspensions of trading and non-reliance on exemptions from the enhanced disclosure and financial reporting provisions.
On-sale 3-month minimum quotation	The on-sale provisions in s708A and 1012DA effectively require that, to get the benefit of the disclosure exemption, the relevant class of securities or interests must have been quoted for at least 3 months before an issue of securities or interests under the rights issue.
On-sale cleansing notice	The on-sale provisions require the issuer to give another cleansing notice to the market operator within 5 business days after the securities or interests are issued (but before any sale offer of the securities or interests).

Non-traditional rights issues

- 4 The disclosure exemption was designed to apply to a traditional rights issue fundraising structure that involves an offer of rights to all existing holders of securities or interests in the same class at the same time to purchase new securities or interests in proportion to their existing holdings where the terms of each offer are the same.
- 5 However, the market has adapted the traditional structure to allow entities to raise funds more quickly and give entities more certainty about the funds that will be in place at a certain time so that they can, for example, proceed with a major acquisition. This has been achieved by accelerating the offers made to institutional holders, an 'accelerated rights issue'.
- 6 Examples of accelerated rights issue structures are:
 - (a) an accelerated institutional issue followed by a retail issue, known as a jumbo structure (this may also be combined with an institutional placement); and
 - (b) a variation of the jumbo structure that allows the rights to be renounceable (holders who do not take up their rights have them sold through an institutional and retail bookbuild and they receive the value of their rights) sometimes known as a RAPIDS structure: 'renounceable accelerated pro-rata issue with dual book builds structure' or an AREO structure 'accelerated renounceable entitlement offer'.

Relief might be appropriate

- 7 We consider that non-traditional rights issues that comply with the spirit of the equal opportunity principle should qualify for the disclosure exemption.
- 8 If issuers are restricted from using the disclosure exemption for non-traditional rights issues, there is a risk that they will continue to undertake institutional placements and the intention behind the disclosure exemption (i.e. to encourage the raising of new capital by pro rata rights issues over non-pro rata methods) will not be fulfilled.
- 9 Section B sets out some specific circumstances in which we consider it might be appropriate to give relief to allow non-traditional rights issues to use the disclosure exemption.

B Proposed relief for non-traditional rights issues

Key points

This section of the consultation paper seeks feedback on some specific circumstances in which it might be appropriate for us to provide relief to allow non-traditional rights issues to use the disclosure exemption.

Timing of offer and allotment

- 10 Where institutional holders have a shorter offer period than retail holders, or the offer or allotment of securities or interests does not occur simultaneously, offers will not be made on the same terms and the issuer will not be able to rely on the disclosure exemption.
- 11 Class Order [CO 05/26] *Constitutional provisions about the consideration to acquire interests* facilitates accelerated rights issues by managed investment schemes by allowing responsible entities to conduct a rights issue where institutional holders are required to notify their acceptance earlier than retail holders are required to do so (i.e. there is a shorter offer period for institutional holders). However, the class order does not allow the responsible entity to issue interests to institutional holders before any of the retail holders at least have the opportunity to be issued their interests. This means that retail holders will still have a subsequent opportunity to take up their interests according to the traditional timetable and be issued interests at a later date.
- 12 Allowing institutional holders to receive an early allotment might make accelerated rights issues more attractive to institutional holders. However, it is possible that this structure could provide institutional holders with an unfair advantage over retail holders, for example by allowing institutional holders to dispose of their new securities or interests for a higher price before securities or interests have been issued to retail holders. Preliminary research by ASIC indicates that some market price anomalies between the institutional and retail issue have occurred, but are not common. Retail interests would also be diluted for a period. One possible reason for delaying retail participation (i.e. to enable them to read the disclosure document) no longer applies.

Proposal

- B1** We propose to give relief to:
- (a) facilitate accelerated rights issues of securities and interests under the disclosure exemption by disregarding mere

differences in timing of when the offer opens and closes (i.e. so that institutional holders have a shorter offer period); and

- (b) allow institutional holders to be allotted securities or interests before retail holders, provided that retail holders are given the option of being allotted their securities or interests at the same time (retail holders may also have the option to have their securities or interests allotted at a later date).

Your feedback

- B1Q1 Do you agree with our proposal? If not, why not?
- B1Q2 If we were to give relief, how should we define an accelerated rights issue?
- B1Q3 Will any practical problems arise from giving retail holders the opportunity to have their securities or interests allotted at the same time as institutional holders? What is the minimum time period that retail holders should be given to decide whether they wish to have their securities or interests allotted at the same time as institutional holders (rather than following the traditional retail timetable)?
- B1Q4 What commercial factors would prevent allotment to retail and institutional holders from occurring simultaneously?
- B1Q5 Could allowing institutional holders to receive securities or interests before retail holders give them an unfair advantage? For example, could institutional holders receive a better market price from an early sale if the securities or interests are allotted to them before retail holders?

Multiple cleansing notices

- 13 The disclosure exemption requires a cleansing notice to be given in the 24-hour period before an offer is made: s708AA(2)(f) and 1012DAA(2)(f). Due to the structure of accelerated rights issues and the obligations in the on-sale provisions in s708A and 1012DA, it is possible that an issuer will have to lodge a number of cleansing notices with a market operator within a short period of time.
- 14 For example, in an accelerated rights issue when offers are made to institutional holders before the retail offer, the issuer will need to lodge a rights issue cleansing notice prior to both the institutional and retail offers. If the issuer is relying on s708A or 1012DA for the on-sale of those securities or interests, an on-sale cleansing notice will have to be lodged within 5 business days after the issue of the securities or interests and before the sale offers are made.
- 15 The s708AA(2)(f) and 1012DAA(2)(f) notices replace the disclosure otherwise required under a prospectus or PDS. Previously, the prospectus or PDS was lodged prior to the commencement of rights trading, (Day 0 under

the timetable at paragraph 3 of Appendix 7A to the Listing Rules). However, we consider that, for the purpose of s708AA and 1012DAA, the actual offers of securities or interests will be made by letter to holders established on the record date, which will be at least Day 6 under the ASX timetable. We consider that it is important that persons engaged in rights trading have the benefit of the disclosure in the cleansing notice from the date rights trading starts.

Proposal

B2 We propose to provide relief so that if a cleansing notice that meets the requirements of s708AA(2)(f) or 1012DAA(2)(f) has been lodged on the commencement of rights trading (Day 0 under the timetable at paragraph 3 of Appendix 7A to the ASX Listing Rules), it is not necessary to lodge a subsequent cleansing notice under s708A, 708AA, 1012DA or 1012DAA unless there is new information that is required to be disclosed. This relief would apply regardless of:

- (a) when the actual offers are made;
- (b) whether there are separate offers to retail and institutional holders; or
- (c) whether the issuer is relying on s708A or 1012DA.

If the issuer is relying on s708A or 1012DA, it must comply with the remaining provisions of these sections (including the 3-month quotation requirement) even with our relief.

Your feedback

- B2Q1** Will our proposed relief create an information gap? Is a second cleansing notice under s708A or 1012DA desirable before trading begins? Should we make this relief subject to the requirement that a subsequent cleansing notice must be lodged if it would contain new information?
- B2Q2** What is the regulatory burden of lodging a notice when each offer and each issue is made? If possible, please quantify the cost.

Disposing of shortfall

16 In some rights issues, not all securities or interests will be taken up under the initial pro rata offer. There are numerous ways of disposing of the resulting shortfall, some of which might require disclosure and, for technical reasons, are likely to fall outside the disclosure exemption. This is because offers of the shortfall are likely not to be:

- a) pro rata;
- b) limited to offers to existing holders; and
- c) on the same terms as the initial pro rata offer.

17 We propose to give relief to enable issuers to deal with any shortfall under a rights issue that otherwise qualifies for the disclosure exemption (as extended by ASIC relief). We consider relief is appropriate for the following reasons:

- a) holders will have had an equal opportunity to participate in the initial pro rata offer; and
- b) if issuers are not given freedom to deal with any possible shortfall, issuers might find rights issues less attractive and the purpose of the disclosure exemption might not be fulfilled.

Proposal

B3 We propose to give relief to enable an issuer to deal with the shortfall in a rights issue as a means of giving full effect to the disclosure exemption.

Your feedback

- B3Q1 Do you agree that we should give relief to enable issuers to deal with the shortfall without prospectus or PDS disclosure?
- B3Q2 Are there any circumstances where we should not give relief to enable issuers to deal with the shortfall without prospectus or PDS disclosure?

Offer to convertible noteholders

18 Where the rights issue is an offer of ordinary shares, an offer to convertible noteholders (or holders of other securities that are convertible into ordinary shares) would fall outside the disclosure exemption because it is not a pro rata offer to all holders in the class of ordinary shareholders. Extending the offer to convertible noteholders will dilute shareholders proportionally, but not necessarily economically.

Proposal

B4 Where the terms of issue of securities that convert into the class of securities offered under the rights issue (such as convertible notes) require a rights issue to extend to holders of the convertible securities, we propose to grant relief to allow these issues to take advantage of the disclosure exemption. We note that our relief would be confined to disclosure requirements, we would not give relief in the context of the takeovers exemption in item 10 of s611.

Your feedback

- B4Q1 Do you agree with our proposal? If not, why not?

B4Q2 Should we limit this relief to the situation where the terms of issue of the convertible securities require the entity to extend a rights issue to holders of the convertible securities or more widely so as to allow the issuer to choose to so extend the issue?

Offer of options

- 19 There is a practice of offering options to subscribe for new shares in the quoted class (concurrent with the offer of new shares) in a rights issue. These offers fall outside the disclosure exemption because they are not an offer of quoted securities and they are not a pro rata offer of securities in a class (e.g. shares) to existing holders in that class.
- 20 The transaction-specific prospectus provisions for continuously quoted securities in s713(3) require prospectus disclosure of the rights and liabilities attaching to the options themselves as well as the underlying securities. However, if we were to give relief to offers of options in a rights issue, investors would not have the benefit of continuous disclosure or a previous prospectus for the options and the market price for the options. There would not be mandated disclosure about the rights and liabilities attaching to the options (beyond what is disclosed in the offer document). The on-sale of the options themselves might also be problematic in light of s707(3).

Proposal

B5 We do not currently propose to give relief to extend the disclosure exemption to cover options.

Your feedback

- B5Q1 Should we give relief so that the disclosure exemption applies to permit a concurrent offer of unquoted options over the quoted securities? If so, why?
- B5Q2 How would the market value the options?
- B5Q3 What would be the disclosure mechanism for information about the options?

Application of the takeovers provisions

- 21 There is a misalignment between the disclosure exemption and the existing takeovers exception for rights issues in item 10 of s611 in the way they treat foreign holders.
- 22 To rely on the takeovers exception, a company undertaking a rights issue must appoint a nominee and issue to the nominee the rights or the securities that would otherwise be issued to foreign holders who accept through the nominee: s615.

- 23 The disclosure exemption and [CO 05/26] adopt the approach taken in ASX Listing Rule 7.7, that if a rights issue is non-renounceable, the offer need not be made to foreign holders.
- 24 Due to this misalignment, an issuer that needs to rely on the takeovers exception and follows the procedures in s615 would not be able to rely on the disclosure exemption and vice versa.

Proposal

- B6** We propose to give relief from s708AA and s1012DAA so that an issuer who wishes to follow the procedure in s615 for foreign holders as an alternative to the procedure in s9A, is able to rely on the disclosure exemption.

Your feedback

B6Q1 Do you agree with our proposal? If not, why not?

Other technical issues

Proposal

- B7** We propose to give additional technical relief as summarised in Table 2.

Your feedback

B7Q1 Do you agree with the additional technical relief we propose to give? If not why not?

Table 2: Proposed technical relief

Beneficiaries	Consistent with [CO 05/26], we propose to give relief so that: <ul style="list-style-type: none"> beneficial holders are taken to be registered holders of securities or interests for the purpose of the disclosure exemption; and an issue of securities or interests to a trustee or a nominee is taken to be an issue to the beneficiary.
Distribution to foreign holders	Where the rights issue is renounceable and the company is required to appoint a nominee approved by ASIC and transfer to the nominee the rights or the securities that would otherwise be issued to foreign holders, we propose to give relief to permit the nominee to distribute to each of the foreign holders their proportion of the proceeds of the sale net of expenses, consistent with the procedure in s615.
Rounding of fractional entitlements	We propose to give relief to allow for rounding of fractional entitlements (up or down) to the nearest whole security.

C Regulatory and financial impact

- 25 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us, we think they will strike an appropriate balance between:
- (a) the aims of the legislation to encourage listed entities to make greater use of rights issues; and
 - (b) the requirements in the legislation that the exemption be limited to offers that are pro rata.
- 26 Before settling on a final policy, we will comply with the requirements of the Office of Best Practice Regulation (OBPR) by:
- (a) considering all feasible options;
 - (b) if regulatory options are under consideration, undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy;
 - (c) if our proposed option has more than low impact on business and individuals or the economy, consulting with OBPR to determine the appropriate level of regulatory analysis; and
 - (d) conducting the appropriate level of regulatory analysis, that is, complete a Business Cost Calculator report (BCC report) and/or a Regulation Impact Statement (RIS).
- 27 All BCC reports and RISs are submitted to the OBPR for approval before we make any final decision. Without an approved BCC Report and/or RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 28 To ensure that we are in a position to properly complete any required BCC report or RIS, we ask you to provide us with as much information as you can about:
- (a) the likely compliance costs;
 - (b) the likely effect on competition; and
 - (c) other impacts, costs and benefits,
- of our proposals or any alternative approaches: see ‘The consultation process’ p. 3.

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission.
Corporations Act	The <i>Corporations Act 2001 (Cth)</i> including any regulations made for the purposes of the Act.
disclosure exemption	Exemption under s708AA and 1012DAA of the Corporations Act from the requirement to provide a prospectus or PDS for 'rights issues' of quoted securities and quoted interests, introduced by the SRS Act.
rights issue cleansing notice	A cleansing notice under s708AA(2)(f) and 1012DAA(2)(f) containing certain prescribed information that the issuer must give to the marked operator in the 24-hour period before an offer is made.
on-sale cleansing notice	A notice required under s708A(5)(e) or 1012D(5)(e) of the Corporations Act.
on-sale provisions	Section 708A and 1012DA of the Corporations Act.
SRS Act	<i>Corporations Legislation Amendment (Simpler Regulatory System) Act 2007 (Cth)</i> .