

15 May 2024

Senator Deborah O'Neill
Chair of the Parliamentary Joint Committee on Corporations and Financial Services
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

Email: corporations.joint@aph.gov.au

RE: INQUIRY INTO THE WHOLESALE INVESTOR AND WHOLESALE CLIENT TESTS

Dear Senator O'Neill and members of the Committee,

On behalf of Wilson Asset Management, I welcome the opportunity to provide a response to the consultation on the proposed changes to the Wholesale Investor and Wholesale Client tests (the "sophisticated investor" test).

We understand the definition of 'sophisticated investor' is now under review by the government and we would like to thank the committee for undertaking a thorough analysis of the potential consequences prior to enacting any changes.

Wilson Asset Management is the investment manager for eight listed investment companies, investing more than \$5 billion on behalf of more than 130,000 retail investors. We are passionate about making a difference, including advocating for the fair and equitable treatment of retail shareholders.

The Corporations Act 2001 regulations regarding corporate disclosure, the issuance of new securities, and the sophisticated investor test are perpetuating the unequal treatment of retail shareholders and allowing the wealthy to profit at the expense of small investors.

While we believe it is important that Australia continues to protect retail shareholders and safeguard our listed and unlisted financial markets, we believe improvements to the framework as outlined below will ensure a level playing field for retail shareholders while also protecting them from high-risk investments without stifling productivity, innovation and growth. Our proposal aims to bring the inequities of wealth-based laws to the attention of the committee.

We request more evidence is presented as to why these changes are being proposed and that there is careful consideration into the potential unintended consequences the changes may have on Australian retail shareholders and businesses.

We also wish to propose two regulatory changes that could help level the playing field between large and small investors:

1. Abolish the wholesale investor test completely for listed companies allowing all shareholders to participate in equity raisings by ASX-listed companies, ensuring fairness to small shareholders. This recognises the effectiveness of the ASX continuous disclosure rules and will encourage companies to value equity from all shareholders versus unfairly excluding smaller retail shareholders.
2. Enhance the sophisticated investor test that currently discriminates between investors according to their wealth by adding a new test of financial literacy to enable those with the relevant experience and qualifications to qualify for the test and not be excluded simply because of their wealth. This is particularly pertinent to companies that are not-listed and therefore pose greater risks for investors. For investors who fall outside of the threshold, there should be recognition of education and experience as an indication of

investment sophistication. The latter will capture those who, for example, are in the profession but do not meet the income or asset tests.

Summary

We are devoted to defending the rights of retail investors and want to highlight the unjust treatment of small shareholders in relation to equity capital raisings in listed markets with respect to share placements, and the unsuitability in this modern era of a sophisticated investor test that categorises people by wealth.

We believe we should test Australian investors on financial literacy instead of wealth by reforming the sophisticated investor test that currently uses wealth as a proxy for financial literacy allowing millions of Australians to inadvertently qualify for accreditation. Regulators should develop a financial literacy test that can accurately assess an investor's capability to understand and engage with financial opportunities, thereby protecting those truly at risk while not arbitrarily excluding others based on wealth alone.

However, in the case of listed markets, it is our view that due to the worldclass disclosure requirements from the Australian Securities Exchange (ASX), the requirement for an investor to qualify as sophisticated in order to participate in capital raisings by ASX-listed companies conducted without disclosure, which primarily exists through share placements should be removed.

We note that restricting certain capital raisings to people that meet the sophisticated investor test has the unintended consequence of barring retail investors from accessing discounted equity capital raisings in listed markets and, in many cases, dilutes their ownership in the company.

This disadvantage is most notable when we see wholesale investors on-selling shares to retail investors following a capital raising on the ASX. Provided the issuing company has been listed for at least three months, wholesale and sophisticated investors that participate in a capital raising may immediately on-sell those shares to retail investors on-market, usually at a higher price when compared to the capital raising price.

In other words, investors who are considered "unsophisticated" are locked out of certain capital raisings but can buy these same shares on the market the very next day, usually at the detriment to them and the advantage of the so-called "sophisticated" shareholders.

This has the perverse outcome that retail investors are considered to need the protection of disclosure when they subscribe to buy shares directly from a company, but need no such protection when they buy those same shares on-market the next day.

In the past 4 years, over 500 ASX-listed companies have raised significant amounts of capital at a discount to market prices. During this time in Australia, 822 placements took place raising a total of \$144.7 billion at an average discount of 12.4% or representing a discount of \$15.7 billion in value given to 'sophisticated investors' versus the capital raisings being available to all shareholders, including retail. The weighted average discount was 11.3%. So those who have the education and experience to invest were put at a disadvantage because of their wealth. This doesn't seem fair.

Sophisticated investor rules are not equitable

The distinction between retail and wholesale investors is a part of the laws governing corporate disclosure set out in s708 of the Corporations Act and accompanying regulations and ASIC instruments.

Companies are required to issue shares under a prospectus unless the issue falls within a specific exemption. One exemption is when companies issue shares to wholesale investors – a class that includes sophisticated investors, professional investors, and financial services licensees.

Investors that are not sophisticated, professional, or licensees are defined as retail investors, and can only access certain new share issuances when a company issues a prospectus. The underlying policy rationale is that an investor sophisticated enough to be able to assess the risks and merits of an investment does not need the protection of a disclosure document.

Current regulations define a sophisticated investor as having assets of \$2.5 million or annual income of \$250,000. ASIC has recommended raising these thresholds in line with inflation, potentially to as high as \$4.5 million or \$450,000.¹ We strongly disagree with the proposed thresholds put forward by ASIC. If the thresholds are to be raised, it should be indexed according to the Consumer Price Index (CPI) or the Wage Price Index (WPI) and it should most certainly come with a financial literacy test.

We propose those who currently qualify should have the current rules applied as they are currently investing under a certain understanding and risk model. It would be unfair to apply the new rules to them, particularly to those who are educated investors that may not meet the new wage threshold.

In our view, the use of wealth as a crude tool to judge investment sophistication is an anachronism in modern Australia and the proposal from ASIC would unfairly exclude a large number of educated individuals from being able to participate in capital raisings in its current form.

It is also out of date – in 2002, less than 2 per cent of the population qualified as sophisticated. Today, more than 16 per cent of the population qualifies, partly due to rising house prices and the inclusion of the family home in the assets test. Blindly increasing the thresholds as suggested by ASIC is not the answer.

Unequal treatment of small shareholders

The arbitrary division of investors according to their wealth is perpetuating the unfair treatment of retail investors.

Section 708 of the Corporations Act permits companies to make share issues without disclosure if they limit access to sophisticated and other wholesale investors. The ASX allows companies to issue up to 15 per cent of new equity via a share placement on a non-pro rata basis each year.

Predictably, companies have flocked to take advantage of these exemptions to avoid the enormous cost and effort of preparing a prospectus. Instead, capital raisings are commonly conducted exclusively for wholesale and sophisticated investors, locking out retail shareholders from participating.

As capital raisings are typically conducted at a discount to prevailing market prices, retail shareholders are significantly disadvantaged when their sophisticated and wholesale counterparts get the chance to buy more shares at a price lower than the market rate.

Offering wealthier shareholders discounted shares is patently unfair to all Australians.

When retail shareholders are excluded from a capital raise, their percentage of ownership in a company decreases, meaning they end up with fewer votes and are entitled to a smaller share of the company's future dividends because their stake has been diluted.

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Australian capital raisings from 2020 to 2024 YTD (>\$20m)

All deals

Number of deals	822
Total capital raised (\$bn)	144.7
Average premium/(discount) to last close	(12.4%)
Weighted average premium/(discount) to last close	(11.3%)
Total premium/(discount) to last close (\$bn)	(15.7)

Source: UBS

¹ <https://treasury.gov.au/sites/default/files/2023-11/c2023-404702-asic.pdf>

Reframing the sophisticated investor test to be fair to all

Wilson Asset Management is classified as a wholesale investor and thus benefits from the existing rules and would further benefit from the proposal put forward by ASIC. In fact, we regularly participate in capital raisings on behalf of our 130,000 shareholders – accessing opportunities that most of them would not be able to seize independently.

However, we do not believe that wealth is a sensible proxy for financial literacy, or that an individual that inherits money or sells a business becomes sophisticated enough to understand investment risk.

There are some simple reforms the government can make to level the playing field fair for all Australians.

Including a financial literacy test, together with or in replacement of the wealth requirement, would allow regulators to better distinguish between investors experienced enough to understand investment risk and those who should continue to benefit from safeguards.

Screening investors by knowledge and experience would help avoid wealthy, but inexperienced, people undertaking investments without a full understanding of potential risks. It would also allow experienced investors of lesser means to participate in wholesale investment schemes.

Finally, excluding the family home from the asset test and only including investment properties would provide a fairer judgement of an individual's investment capabilities based on the assets test.

Allowing fair access to ASX capital raisings

All investors should be allowed to access capital raisings conducted via the placement of securities by ASX-listed companies. The argument for restricting retail shareholders' access to such capital raisings is founded on a belief that a higher standard of disclosure provides a degree of protection when assessing whether to invest. The risk is limited when a company is listed on the ASX.

The Corporations Act requires listed companies to disclose material price sensitive information on a timely basis. The ASX has detailed and well-enforced rules on disclosure that require companies to immediately notify "any information ... that a reasonable person would expect to have a material effect on the price or value of the entity's securities".²

Australia's robust continuous disclosure regime is already acknowledged in s708AA of the Corporations Act which allows companies to conduct rights issues to all shareholders without having to prepare a prospectus. Rights issues are a form of capital raising in which existing shareholders are given the right, but not the obligation, to purchase additional shares from a company at a specified price. ASIC also acknowledges the efficacy of continuous disclosure in class order relief that allows companies to offer \$30,000 worth of shares per shareholder per year without disclosure.

The policy reasoning behind this is that the continuous disclosure regime ensures all relevant information is available to all investors.

New Zealand reforms offer a model for Australia to follow

New Zealand has long enshrined in law the right for all shareholders to participate in any offer of securities in a class already traded on the New Zealand Stock Exchange without requiring a prospectus to be issued.

The basis for that reform was NZ's strong continuous disclosure rules that mean new disclosure documents are redundant. The same holds true in Australia – the ASX is a world-leading securities exchange with equally robust continuous disclosure obligations.

Conclusion

Wilson Asset Management believes all shareholders should be treated fairly – regardless of their wealth. Favouring the affluent at the expense of everyday Australians contradicts the very principles our nation was built on.

Reforming laws governing capital raisings and refining exemptions for sophisticated investors is critically important to levelling the playing field for all Australians. We should consider a sophisticated investor test to allow us to mark people on their knowledge, not on their perceived wealth.

² <https://www.asx.com.au/documents/rules/Chapter03.pdf>

Further, there should be a carve out for ASX Listed investment companies who are governed by a world-leading securities exchange with robust continuous disclosure obligations.

If you have any questions on our submission, please call me on (02) 9247 6755 or 0412 242 712, or email gw@wilsonassetmanagement.com.au or call Chief Financial Officer Jesse Hamilton on (02) 9247 6755 or 0401 944 807 or email jesse@wilsonassetmanagement.com.au.

Yours sincerely,

A handwritten signature in black ink, consisting of a large, stylized 'G' followed by a horizontal line extending to the right.

Geoff Wilson AO
Chairman & Chief Investment Officer
Wilson Asset Management