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Let's break open the door to the closed-shop IPO

ADAM CREIGHTON THE AUSTRALIAN 12:00AM June 9, 2018

Forget clueless superannuation members. Financial illiteracy appears to extend to the most senior government ministers.

Responding to a deluge of complaints in mid-2016 — that small investors were being systematically locked out of the best initial public offerings — Scott Morrison assured them changes were afoot.

"The Australian Stock Exchange is proposing to introduce a requirement that a company must have at least 20 per cent of its shares available to the public when it lists on the exchange …. bringing (it) in line with peer exchanges in Hong Kong, Singapore and New Zealand," the Treasurer wrote.

Yet in the near two years since, nothing like that has happened. Ordinary Australians have nowhere near the same rights their counterparts have in those countries, which is bizarre given a self-managed superannuation funds pool that recently burst through $700 billion.

Sure, the ASX in late 2016 introduced a "free float" requirement that 20 per cent of a listing entity's main class of securities could not be restricted and must be held by non-affiliated shareholders. But that has little to do with public access: the rule could be satisfied by selling the stock at an IPO to an institution. It doesn't entitle the public to one share.

For all the talk this week about the delayed Prospa IPO, managed by UBS and Macquarie, I wonder how many people reading about it have had a chance to buy a share? None, is the most likely answer.

The royal commission into financial misconduct has been inundated with hundreds of letters — some seen by *The Weekend Australian* — from retail investors hoping the commission's remit will extend to investment banks and capital markets.

One complains of the "deep-seated inequality in initial public offering markets". He goes on: "IPOs are a key part of our current financial system … however, these offerings tend to be allocations based on secret commissions paid by institutions to lead managers (investment banks)."

Another writes: "Even before lodging a prospectus, a company can make an IPO private … locking out retail investors from a good investment opportunity". What's the point of law mandating a readable prospectus if the company is already sold before it’s read by a single retail shareholder?

The competition regulator’s criminal cartel charges against ANZ and two global investment banks, Citi and Deutsche, also point to potential design flaws in Australia’s capital markets.

In 2015, ANZ raised $2.5bn via a share placement; that is, it hired three investment banks to sell the shares rather than ask its own shareholders to chip in.

For whatever reason, the banks couldn’t sell all the stock and ended up having to mop up the excess, worth $790 million — that’s how underwriting works.

Did they then keep this quiet so they could sell their holdings slowly without taking the sails out of the price? That’s the cartel allegation.

The ACCC must be confident to take on such big fish. It defies credulity JPMorgan would have helped it — the US banking giant has received immunity — without the endorsement of its global chief executive, Jamie Dimon, in New York.

Bankers are shocked because, apparently, this is normal practice in underwriting. Normal practice might be good for profits but is it underpinning confidence and efficiency in financial markets?

The 2014 financial system inquiry, overseen by David Murray, pointed out that emerging technology should make it easier for companies to offer placements and IPOs to a wider range of shareholders.

Others would prefer to submerge the technology.

For instance, when Wisetech, a successful logistics firm, issued $100m worth of shares in 2016 in an IPO, it sought out ASX Bookbuild, a joint venture between the ASX and OnMarket, which provided a proven algorithm that could help newly listing firms achieve a higher price for their stock and broaden their shareholder base beyond the clients of the big investment banks.

Yet the ASX and other investment banks appear to have pressured Wisetech not to use it. Indeed, the ASX, which receives a significant chunk of its revenue from investment banks, stopped offering ASX Bookbuild as a service in January.

The Australian technology that had been feted by UK regulators in 2015, with a pricing and allocation system patented in 10 major capital markets, is now out of action. So much for the ideas boom.

ASIC knows there are problems, but has been reluctant to act. In 2012, then commissioner Belinda Gibson observed "some significant distrust in the market about the process", promising to "seek law reform".

The securities regulator is currently looking at whether allocation processes for IPOs and placements are fair, but so far there's no foreshadowing of rules that would guarantee retail investors get a look in.

Regulators worry about market access in other countries too. If the funnel for pouring capital into new businesses is clogged with bonuses and favouritism, the real economy suffers.

After the 2015 UK Royal Mail debacle, where investment banks sold the publicly owned post office to clients for billions of pounds less than it was worth, the relevant regulator later found "evidence consistent with book-runners making favourable allocations to investors with whom they generate the greatest revenues elsewhere in their business, notably through brokerage commissions".

Why not set aside a share of new stock for ordinary investors? In Hong Kong, a much bigger market than Australia, 25 per cent of new IPO shares are available for public bidders. Singapore and New Zealand similarly guarantee the public get a look in.

Sure, the retail investors in Australia can buy the shares after the new firm has listed, but then the prices is higher — typically about 15 per cent. Initial investors need a discount — a guaranteed capital gain — to invest upfront.

The royal commission should also examine how capital is raised in Australia. It's a fair bet practices would fall below community expectations — the commission's prescribed benchmark for recommendations — if people, including ministers, understood what was going on. Right now, the economics of IPOs looks like this: insiders get the best IPOs, the risky ones are available for the 1.2 million SMSF holders.

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Adam Creighton is an award-winning economics journalist with a special interest in tax and financial policy. He spent most of 2016 at the Wall Street Journal in Washington DC. He won the Citi Journalism Award for Excellence in 2015, and was runner up in the internationally recognised Bastiat Prize for Journalism in 2014. He started his career at the Reserve Bank of Australia and studied economics at Oxford, where he was a Commonwealth Scholar. In 2017 he was appointed to the National Archives of Australia Advisory Council.