LIC Governance Spotlight
Share Buy-Back

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In this update we look at Share Buy-backs in the Listed Investment Company (LIC) sector as a capital management initiative. We examine the general rules that apply, the types of buy-backs that should be considered and the disclosure considerations for LICs. This update does not intend to consider when a share buy-back should be considered. It aims only to provide an overview of the governance aspects for LICs to consider.

In the three years to 31 January 2017, the LIC sector in Australia has grown to a market capitalisation of $31.4 billion.1 The growth last year was over $3 billion.2 LICs remain a popular investment choice for investors looking for a consistent dividend return.

Factors causing LICs to trade at a substantial discount to their NTA have caused boards to consider capital management initiatives. One of the main initiatives considered by LICs is a Share Buy-back.

Recent examples indicate a buy-back may have assisted in narrowing the discount. Ellerston Asian Investments Limited (ASX:EAI) announced a share buy-back on 13 September 2016. The buy-back commenced on 27 September 2016 and the company reported that the discount to NTA narrowing from approximately 19% to approximately 10% as at 31 September 2016.

General Rule
A company may only buy-back its shares if the buy-back would not materially prejudice its ability to pay its creditors. A director of a company is not relieved of the usual directors’ duties under the Corporations Act 2001 (Cth) (the Act) or a director’s fiduciary duties due to the corporate actions approval by shareholders.

For example, the duty to prevent insolvent trading is a duty imposed on directors regardless of any direction from shareholders including at a general meeting. Section 588G(1A) addresses this issues in relation to buy-backs as it deems a company to have incurred a debt for the purposes of the insolvent trading provisions in the Act when the relevant buy-back agreement is entered into. Directors are obligated to ensure that any buy-back does not prejudice creditors and that the LIC can continue to pay its debts as and when they fall due and payable.

The LIC should also consider its own constitution to ensure there are no restrictions on a buy-back or additional/ specific approvals that may be required. In most cases it will be sufficient to rely on the Listing Rules and the Act.

Types of Buy-backs
The most common type of Buy-Back in the LIC sector is an on-market buy-back and equal access scheme buy-back.

Each type of buy-back requires a different procedure to be followed. The characteristics of buy-back most relevant to LICs are briefly summarised below:

- **On-market buy-backs**
  
  An on-market buy-back takes place when a listed corporation buys back its own shares in the course of normal trading on a prescribed financial market.
Equal access scheme buy-backs
Equal access buy-back schemes are ones in which buy-back offers are made to every holder of ordinary shares to buy-back an equal proportion of each party's holding. A reasonable period must be given for each party to accept and no agreements may be entered into until the offer period has ended. The important feature of these schemes is that the terms of the offer must be the same for each offeree.

Additional ASX Disclosure Requirements
For listed companies, the procedures set out in the Listing Rules must be observed in addition to the Corporations Act, including:

- **Listing Rule 7.29 - Pre-condition for an on-market buy-back**
  A company may only buy-back shares under an on-market buy-back if transaction in the company's shares were recorded on ASX on at least 5 days in the 3 months before it buys back the shares.

- **Listing Rule 7.33 - Purchase price under on-market-buy-back**
  A company may only buy-back shares under an on-market buy-back at a price which is not more than 5% above the volume weighted average market price for securities in that class calculated over the last 5 days on which sales in the shares were recorded before the day on which the purchase under the buy-back was made.

- **Appendix 3C (Announcement of Buy-back)**
  In the case of an on-market buy-back, immediately the company decides that it wants to buy-back shares it must issues an Appendix 3C.

- **Appendix 3D (Change relating to Buy-back)**
  Immediately any change is made to information the company has given to ASX in an Appendix 3C or Appendix 3D, it must release an Appendix 3D.

- **Appendix 3E (Daily Notification)**
  At least half an hour before the commencement of trading on the business day after any day on which shares are bought back, the Company must do an Appendix 3E.

- **Appendix 3F (Final Notice)**
  At least half an hour before the commencement of trading on the business day after any of the following:
  - The company buys back the maximum number of shares that it wanted.
  - The company decides it will stop buying back shares.
  - If the buy-back is an equal access buy-back scheme, on the last day of the offer period the Company must do an Appendix 3F.

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1. Monthly Reports, ASX Listed Companies (LICs) (31 January 2017) MorningStar
2. Ibid.