



2018 AUSTRALIAN IPO REVIEW: REGULATORY DEVELOPMENTS

16 April 2019 | Australia

Legal Briefings - By **Philip Hart and Cecilia Mehl**

Whilst the Banking Royal Commission has attracted the most attention, in 2018 both ASIC and ASX continued to focus on improving listing practices of issuers, advisers and market participants, with ASIC issuing new guidance regarding the allocation of securities and ASX proposing amendments to its listing rules and guidance notes. 2018 also saw the formal commencement of ASIC's regulatory guidance of sell side research, Regulatory Guide 264: Sell-side research (**RG264**).

ASIC

ALLOCATIONS OF SECURITIES

Continuing ASIC's focus on conflicts of interest, ASIC has provided timely guidance to Australian financial services licensees and issuers in relation to improving their processes for allocating securities in IPOs and other equity raising transactions. In December 2018, ASIC published *ASIC Report 605: Allocations in equity raising transactions* (**REP605**). REP605 supplements ASIC's other recent guidance on allocations in equity raising transactions and managing conflicts of interest,¹ and follows similar reports from other regulators including the FCA in the UK in October 2016 and IOSCO in September 2018.

Over a 12 month period, ASIC examined the allocation practices adopted across 16 fundraising processes, ranging in size and structure, as well as the policies, procedures and practices of a range of large and mid-sized licensees. The focus of its review was how licensees make allocation recommendations to issuers and manage conflicts of interest. ASIC observed that even where licensees have allocation policies and procedures in place (which was generally true of the larger licensees surveyed), market practice varied greatly and conduct did not always reflect what ASIC regards as 'better practice'.

REP605 details a number of suggestions for improving allocation practices, including that licensees engage with the issuer throughout the transaction to better understand the issuer's objectives (and ensure such objectives take priority over the licensee's interests and business relationships), disclose to the issuer and manage any potential conflicts of interest (for example proposed allocations to related investment managers or employees/principal accounts of the licensee – the latter of which should only be done if an offer is undersubscribed), ensure messaging to investors is consistent across all investors, accurate, and updated if previous communications become inaccurate, and keep detailed records of reasons for making allocation recommendations. REP605 also strongly encourages issuers to actively engage in the allocation process, for example by requesting a copy of the licensee's allocation policy, and asking the licensee to explain the basis for its allocation recommendations and how those allocations reflect the issuer's objectives. Issuers are also cautioned to take care when reviewing and releasing ASX announcements summarising the outcome of a fundraising to ensure that the market is given an accurate, and not exaggerated, snapshot of the success of the offering.

There are clearly commercial imperatives and realities that underpin the interaction between licensees and issuers in the context of allocations. ASIC's key message appears to be that the issuers' interests must always be put first, and that licensees should review their policies and procedures to ensure that they are consistent with ASIC's recommendations.

OBSERVATIONS FROM CORPORATE FINANCE REGULATION, INCLUDING LEARNINGS FOLLOWING THE BANKING ROYAL COMMISSION

In August 2018, ASIC released its biannual report on corporate finance regulation, *ASIC regulation of corporate finance: January to June 2018 (REP589)*, in which ASIC discusses its key observations from its oversight of transactions during the period. In the report, ASIC touches on a few areas where it can see room for improvement of IPO practices. ASIC notes that it issued significantly more interim stop orders over the six months to June 2018 (24 in total – being the outcome of 26% of reviews) and it extended 27 exposure periods (being the outcome of 40% of reviews). ASIC's top disclosure concerns were: inadequate disclosure of the business model, unclear disclosure around use of funds, misleading or deceptive disclosure, inadequate or insufficiently tailored risk disclosure and inadequate disclosure of substantial holdings and capital structure.

ASIC also raised concerns about promotion of IPOs outside formal disclosure documents, including advertisements made by the issuer and investor education reports being leaked to the media. Initial coin offerings continue to experience considerable teething problems as industry participants muddle through how they are regulated.

In the wake of the release of the Banking Royal Commission final report on 4 February 2019, ASIC encourages financial services companies seeking to undertake an IPO to disclose to potential investors how their business may be affected by the issues raised by the report. This would include any relevant historical and current interaction with regulators and possible outcomes of those interactions, as well as any specific regulatory risks that the business may encounter. With the government confirming that it is likely to act on most of the report's recommendations, financial services companies seeking to undertake an IPO should be aware of any findings and recommendations that may affect expectations of what they should disclose to potential investors. As an example, financial services companies receiving grandfathered commissions should disclose how the abolishment of this conflicted remuneration, which the government has indicated it intends to implement from 1 January 2021, will affect future profits. It would also be worthwhile for financial services companies to disclose any changes they have made in response to the Commission's findings and recommendations, such as to remuneration practises that contribute to misconduct, or removal of conflicts of interest that were to the detriment of the customer.

GUIDANCE ON SELL-SIDE RESEARCH NOW IN EFFECT

As flagged in our 2017 Australian IPO Review, ASIC published RG264 in December 2017 with the aim of improving the practices of licensees in the handling of material, non-public information and management of conflicts of interest. Readers should be aware that RG264 has now taken effect as at 1 July 2018, and should ensure their compliance measures conform to the standards set out in the guidance.

Whilst market practice in respect of pre-deal research in the post RG264 landscape continues to evolve, we have observed that, whilst generally issuers and licensees continued to see value in preparing pre-deal research, many licensees have moved away from including formal valuation ranges in pre-deal research. Furthermore, the type and extent of other valuation information included in pre-deal research tends to vary on a case-by-case basis, having regard to the nature of the issuing company and its business.

ASX

AMENDMENTS TO GUIDANCE NOTE 1

Guidance Note 1 (Applying for Admission) was amended in March and July 2018 to:

- identify brokers from which ASX will accept overseas criminal history or bankruptcy checks for persons who will be directors of a company once listed, and to clarify that statutory declarations will only be accepted where such checks are not available from the country in question;
- expand the meaning of security holdings obtained by “artificial means” in the context of achieving minimum spread;

- enable ASX to request a report confirming the number of applications received from verified persons to ensure that the minimum spread has been met without artificial means; and
- require the prospectus or PDS of a company established outside Australia seeking to list on the ASX to summarise any taxes or duties that an investor will be required to pay in the company's place of incorporation, registration or establishment (as applicable) or, if there are no such taxes or duties, a statement to that effect.

PROPOSED AMENDMENTS TO ASX LISTING RULES AND GUIDANCE NOTES

In November 2018, ASX released a consultation paper titled *Simplifying, clarifying and enhancing the integrity and efficiency of the ASX listing rules*, which proposes and seeks feedback on a range of amendments to the ASX Listing Rules (**Listing Rules** or **LR**) and its appendices, and Guidance Notes. The proposed amendments are intended to improve market disclosures and other market integrity measures, simplify the Listing Rules, improve efficiency of the listing process and ongoing compliance with the Listing Rules, and enhance ASX's powers to enforce compliance.

Some of the key proposed changes to the Listing Rules and Guidance Notes that may be relevant for companies seeking to undertake an IPO include the following:

- companies seeking to list under the assets test can no longer include budgeted revenue and budgeted administration costs for the first full financial year following listing in their working capital calculations (LR 1.3.3);
- CEOs will need to satisfy the good fame and character requirements that directors are currently required to satisfy as a condition for admission (LR 1.1 condition 20);
- persons appointed by a company to communicate with ASX on Listing Rule issues must complete and pass an approved Listing Rule compliance course (LRs 1.1 condition 13 and 12.6);
- companies that are required to lodge quarterly cash flow reports (such as mining companies and start ups) need to disclose their actual use of funds since listing against the intended use of funds disclosed in the listing disclosure document in respect of the quarter, and explain the reason for any material differences(LR 4.7C);
- companies may rely on a provision in their constitution that only requires certain significant holders of securities (for example substantial holders, related parties, service providers and their associates) to execute mandatory (ie ASX imposed) escrow agreements, while such restrictions may be imposed on other security holders with notice provided by the company without executed escrow agreements (Chapter 9, Appendix 9A); and

- ASX will only waive the requirement for security holders to approve acquisitions and disposals of substantial assets, or issues of equity securities, involving certain persons in a position of influence, in exceptional circumstances where there is no reasonable prospect of such persons (either themselves or through their connections) influencing the transaction, with ASX noting that “the bar in this regard is high” (LRs 10.1, 10.11, Guidance Note 24, Guidance Note 25).

Feedback on the consultation package is due by 1 March 2019. ASX proposes to implement the changes on 1 July 2019.

ENDNOTES

1. See Report 486: Sell-side research and corporate advisory: Confidential information and conflicts (August 2016) and Regulatory Guide 264: Sell-side research (December 2017), the latter of which was discussed in our 2017 Australian IPO Review.

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