HERBERT SMITH FREEHILLS

2019 AUSTRALIAN IPO REVIEW: REGULATORY DEVELOPMENTS

28 February 2020 | Australia
Guides – By **Philip Hart, Rob Finlay and Fiona Smedley**

In 2019, ASIC and ASX have had a continued focus on enhancing the integrity and corporate governance practices of entities seeking to conduct IPOs, with ASX's amendments to the Listing Rules and the Corporate Governance Principles and Recommendations coming into effect and ASIC issuing various reports and amended guidance calling for strengthened conflict management and disclosure practices. Australian regulators are also focussed on heightening protection for retail clients, which has implications for the marketing of and distribution of securities for IPOs.

ASIC

ASIC ACQUIRES NEW PRODUCT INTERVENTION POWERS

On 6 April 2019, ASIC acquired broad new product intervention powers which ASIC can use in relation to initial and secondary capital raisings where ASIC identifies actual or likely 'significant detriment' to retail clients or consumers.

These new powers have been a long time coming. They were recommended by the Financial System Inquiry in 2014 and have now been inserted into the *Corporations Act 2001* (Cth) and the *National Consumer Credit Protection Act 2009* by the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Cth).

These product intervention powers apply to a broad range of financial products (including shares and interests in managed investment schemes) and credit products that are, or are likely to be, available to retail clients or consumers.

The intervention orders can be made in relation to a specific product or a class of products, where ASIC is satisfied the product or class of products has or is likely to result in significant detriment to retail clients or consumers. Significant detriment may arise through a product's design/features or its distribution. It may arise when there is no breach of disclosure laws or other financial services regulatory requirements.

A range of intervention orders are available, that can affect to whom the product can be sold and in what manner, and can extend to a total ban on a product or class of products. Orders may be made for an initial period of up to 18 months, which can be extended or made permanent with the consent of the Minister. Before making an intervention order, ASIC must consult with persons who are reasonably likely to be affected by the order, but consultation may take the form of publishing a notice on the ASIC website, and a failure by ASIC to consult does not invalidate an order.

In *ASIC Consultation Paper 313: Product intervention power* and its attached draft Regulatory Guide, ASIC gives guidance on factors it proposes to take into account in applying the significant detriment test and provides case studies involving term deposit rollover and flex commission in the car finance market. Whilst this consultation has closed, we are awaiting the issue of the final Regulatory Guide.

In the meantime, in August 2019, ASIC commenced consultation on proposed product intervention orders in relation to over-the-counter binary options and contracts for difference. In September 2019, ASIC made its first product intervention order to limit aggregate credit and collateral fees on certain short term credit facilities.

NEW DESIGN AND DISTRIBUTION OBLIGATIONS ARE FINALISED

The *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Cth) also introduced a new design and distribution regime into the *Corporations Act 2001* (Cth). Unlike the product intervention powers which took effect immediately under this legislation, the design and distribution regime has a two year transition period and does not take effect until 5 April 2021.

Broadly, the new design and distribution regime will in some circumstances require the issuer (and in some cases the seller) of financial products to make and publish an appropriate target market determination (**TMD**) for the products offered.

This TMD must (among other things) describe the 'target market' for the financial product, identify TMD review triggers and specify any distribution conditions.

When a TMD is required, the issuer (or seller) and all distributors to retail clients or consumers must take reasonable steps to distribute the financial product to retail clients in accordance with that TMD.

The design and distribution regime applies to some IPOs, where:

- a product disclosure statement is required for the offer (which would be the case if the offer is of interests in a managed investment scheme alone or stapled to other financial products); or
- a prospectus is required for the offer and the offer is not an offer of fully paid ordinary shares in an Australian or foreign company or an employee share scheme offer. Two exceptions to this rule apply. For anti-avoidance reasons, the design and distribution regime does apply to offers of:
    - shares in a company that carries on a business of investment in financial products, interests in land or other investments using funds subscribed under a public offer (ie, an investment company); and
    - ordinary shares intended to be converted to preference shares within 12 months of issue.

In *ASIC Consultation Paper 325: Product design and distribution obligations* (**CP325**) and its attached draft Regulatory Guide, ASIC has provided only broad guidance as to the content of a TMD. Although the TMD is not required to specify a 'negative target market' (unlike the position in Europe), the draft Regulatory Guide notes that it will be useful for the issuer to consider those for whom the financial product is clearly unsuitable. ASIC identifies factors it expects will be relevant in determining if the issuer or a distributor has taken reasonable steps to distribute the product in accordance with the target market determination. Comments on CP325 close on 11 March 2020.

CONSULTATION ON STAMPING FEE EXEMPTION

On 27 January 2020, the Government announced that the Treasury would undertake a four week targeted public consultation on the merits of the current stamping fee exemption for capital raisings by listed investment companies and listed investment trusts, including real estate investment trusts.

The stamping fee exemption is an exception to the Future of Financial Advice rules on conflicted remuneration for financial services licensees. Since it was introduced in 2014, this exemption has been regularly utilised to facilitate the payment of fees and commissions by listed (or to be listed) issuers on IPOs and other capital raisings out of the proceeds of the offering to underwriters and other brokers in the selling syndicate.

The consultation comes in response to the Financial Services Royal Commission recommendation that all exemptions for conflicted remuneration be reviewed by 2022. Submissions for the public consultation closed on 20 February 2020.

ASIC REPORT 641 ON SMALL-CAP MINING IPOS

On 5 December 2019, ASIC released its report, *ASIC Report 641: An inside look at mining and exploration initial public offerings* (**REP641**), which set out the findings from ASIC's review of the processes undertaken in selected mining IPOs raising less than A$20 million conducted between October 2016 and September 2018.

In summary, ASIC was concerned with the heavy involvement of lead managers and other promoters throughout the IPO process, potentially resulting in conflicts of interest and substandard compliance controls.

Although ASIC focussed on small-cap IPOs in the mining sector, ASIC has publicly stated that the concerns raised in REP641 and the recommended "better practices" needed to address them are relevant to most, if not all, companies, directors and lead managers in Australia.

The following are some of the key "better practice" recommendations set out by ASIC in REP641:

- **Directors should be aware of their duties and be actively involved in the IPO process**: Given the influence of lead managers and other professional advisers in the IPO origination process, directors should ensure that they are acting in the best interests of the company when making decisions, including in relation to proposals put forward by the transaction originators, and maintain robust conflict management processes.

- **Directors need to take more control of the pre-IPO funding process**: If a company is seeking to undertake pre-IPO fundraising, directors should exercise more control over and understand the rationale behind the pricing, quantum and allocation strategy for the seed capital.

- **The role of lead managers should be clear**: Lead manager and corporate advisory mandates should clearly identify the obligations and responsibilities of the lead managers and disclose any conflicts of interest and how these conflicts will be managed. Prospectus disclosures should also clearly and prominently set out the total aggregate benefits payable to lead managers, including contingent liabilities.

- **Promotional activities must be subject to compliance controls**: Promotional materials for IPOs should provide a balanced view of the proposed investment and not be used to make statements that could not be made in a prospectus.

- **IPO allocations**: ASIC recommends for lead managers and companies to review and implement the better practices set out in ASIC's *Report 605: Allocations in equity raising*

transactions (REP605), which sets out ASIC's recent guidance on allocations in equity raising transactions and managing conflicts of interest.

ALLOCATIONS OF SECURITIES

In our 2018 Australian IPO Review, we discussed REP605 which was released in December 2018. In that report, one ASIC suggestion was that the messaging of bookbuild updates to investors be consistent across all investors, accurate, and updated if previous communications become inaccurate. In 2019, we saw an increase in the extent of bookbuild messaging, which was more commonly done by way of Bloomberg or other written forms than previously. In our experience, bookbuild messages also became more conservative in relation to the progress of the bookbuild. During the year, we also saw more media reporting of bookbuild updates.

ASX

ASX has made a range of amendments to the ASX Listing Rules, its appendices and Guidance Notes that, with limited exceptions, came into effect on 1 December 2019. The key changes to the Listing Rules and Guidance Notes that are relevant for companies seeking to undertake an IPO relate to eligibility for listing, deferred trading and escrow requirements.

ELIGIBILITY

The key changes to the Listing Rules and Guidance Notes that relate to eligibility for listing 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;
- companies seeking to list under the assets test must also set out the objectives they are seeking to achieve from admission and any capital raising undertaken in connection with admission in the disclosure document;
- CEOs and CFOs will need to satisfy the good fame and character requirements that directors are currently required to satisfy as a condition for admission;
- persons appointed by a company to communicate with ASX on Listing Rule issues must complete and pass an approved Listing Rule compliance course. To allow more time to complete the development of ASX's online education course and examination, the transition date for this particular rule change is 1 July 2020.

Additional warranties to ASX have also been added to the relevant ASX listing applications which state that the securities to be quoted by ASX have been validly issued and all of the relevant documents and information given to ASX are, or will be, accurate, complete and not misleading.

DEFERRED SETTLEMENT TRADING

Deferred settlement trading for IPOs will generally be limited to conditional markets where trading is initially on a conditional and deferred settlement basis. In other cases:

- IPO offers that do not include a "general public offer" can start trading on a T+2 basis as soon as securities are issued;
- IPO offers that include a "general public offer" have to wait 3 business days after holding statements are dispatched to start trading on a T+2 basis.

MANDATORY ESCROW

ASX has also introduced changes to the mandatory escrow regime designed to reduce the administrative burden for applicants seeking to list on ASX.

Broadly, mandatory escrow restrictions are imposed in relation to IPOs of early stage and other start-up or speculative businesses admitted under the assets test that do not have a track record of revenue or profitability acceptable to ASX.

Under the amended rules, the form of mandatory escrow documentation will vary based on the relationships between the securityholder and the issuer. ASX will require certain securityholders that are closely related to the issuer (for example, related parties, promoters, substantial holders, professional advisers and their associates) to execute formal escrow deeds. For other holders, ASX will permit entities to rely on a provision under their constitution containing the appropriate escrow restrictions and to simply give notice to the holder of the restricted securities advising them of those restrictions.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE

There has been an increased focus on environmental, social and governance (**ESG**) in Australian regulation. In the fourth edition of the ASX Corporate Governance Principles and Recommendations (**ASX Principles and Recommendations**) released in February 2019, the key change was a shift towards recognising the importance of monitoring and taking responsibility "from the top" for culture, conduct and behaviour within the corporate group and for focussed management of and disclosure in relation to non-financial risks, including ESG risks, in addition to the traditional focus on financial risks and performance.

ASIC has also released revised guidance on climate change-related disclosures in *ASIC Regulatory Guide 228: Prospectuses: Effective disclosure for retail investors* (**RG228**) and *ASIC Regulatory Guide 247: Effective disclosure in an operating and financial review* (**RG247**), which make clear that companies seeking to conduct an IPO should consider disclosing climate change risk in its prospectus.

Specifically, RG228 includes the types of climate change risk developed by the G20 Financial Stability Board's Taskforce on Climate Related Financial Disclosures into the list of examples of common risks that may need to be disclosed in a prospectus. This sentiment is also echoed in RG247, which describes climate change as a 'systemic risk that could have a material impact on the future financial position, performance or prospects of entities'.

In a media release in August 2019, ASIC has also stated that in the coming year, it will 'conduct surveillances of climate change related disclosure practices by selected listed companies'. Taken together, it is clear that a key focus of the Australian regulators in the coming year will be on the adequacy of the climate change-related risk disclosures.

Please click here to return to the main page

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

PHILIP HART
PARTNER, SYDNEY

+61 2 9225 5703
philip.hart@hsf.com

FIONA SMEDLEY
PARTNER, SYDNEY

+61 2 9225 5828
Fiona.Smedley@hsf.com

LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

© Herbert Smith Freehills 2023

SUBSCRIBE TO STAY UP-TO-DATE WITH INSIGHTS, LEGAL UPDATES, EVENTS, AND MORE
Close

© HERBERT SMITH FREEHILLS LLP 2023