Law Council
OF AUSTRALIA

Business Law Section

18 July 2019

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Australian Securities and Investments Commission
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Dear Mr Jukes

ASIC Report 605 on Allocations in Equity Raising Transactions – feedback

In late December 2018, the Australian Securities and Investments Commission (**Commission** or **ASIC**) issued its findings on allocations in equity raising transactions in Report 605, welcoming feedback on the issues raised in the report.

The Business Law Section of the Law Council (**BLS**) is generally complimentary of the report and sees it as a very balanced and useful guide for participants in the market based on the Commission's analysis of 16 Australian equity capital raisings of different sizes and complexion. In particular, the BLS members with expertise in equity capital raisings found the vast majority of the observations in the report consistent with their experience and found observations outside their immediate visibility (e.g. because in private practice) to be of likely assistance to issuers, market participants and advisers.

In their review of Report 605, those BLS members felt it would be useful to provide general feedback and to comment on the following additional points:

- **Role of compliance** – we note the references to "compliance activities" in C2 of Report 605. Although we agree that there is a role for compliance teams to play in bookbuild messaging, we do not believe that responsibility for all of the better practices set out in section C2 should be that of compliance teams. In our view, primary responsibility for bookbuild messages sits with those charged with running the book, not the compliance team. It is appropriate that those corporate advisory senior managers ensure compliance of the book and bookbuild messages with all legal and regulatory requirements. Compliance may have a role in this and undertake some of the better practices set out in items (a) to (e) in section C2 but failure to implement all of these better practices by compliance teams (in particular compliance review of bookbuild messages) should not be interpreted as deficient compliance.

- **1D VWAP metrics** – statistics comparing the issue price in IPOs and placements against the volume weighted average price for the first day of trading (**1D VWAP**) in the after-market in the report (paragraphs 31-34) are extremely valuable data points, were compiled over a significant period and from a statistically significant number of transactions. That information is extremely useful. However, the BLS

does not agree with the conclusions/comments reached in response to those data points – namely that issuers are not considering the terms on which securities are issued as actively as they should (paragraphs 13, 14, 23, 46, 149-150, section D2 and elsewhere). Specifically:

- "**Discounts**" – it is almost universal practice that equity securities are issued at a discount to the prevailing or expected market price of existing equity securities.
- **Metrics** – the size of 1D VWAP discounts evident in these statistics is not at a level which ought to raise concern in the view of the BLS members.
- **International comparison** – while the BLS has not conducted comparative international studies, these levels of discount appear to be at or below the level commonly experienced in international markets, especially those in other parts of Asia.
- **Transaction risk** – finer pricing in transactions has the potential to risk the success of capital raisings.
- **Underwriting** – even in the case of fully underwritten transactions, the after-market risk to existing shareholders of overhang arising from shortfalls militates towards discounts that minimise that possibility.

- **Allocable demand** – paragraphs 170 and 171 make observations on bookbuild messaging by reference to allocable demand and use of terms such as "covered", "well covered" and "cornered". The report makes a number of observations that reference allocable demand and the manner in which it can be treated in different contexts. In our experience, this is one of the most difficult elements of the allocations process, it being almost impossible for a licensee running a bookbuild to estimate the level (if any) of bid inflation in a scientific way.

  There is also a suggestion in item (e) of section E1 that the licensee should exclude any bids it deems "excessive" (considering its knowledge of the investor) which places undue onus on a licensee to look behind bookbuild bids. In our view, the only feasible way to approach demand is to take all bids (in the absence of manifest error) at face value. To do otherwise creates potential regulatory issues including compliance with the Commission's Market Integrity Rules and the Corporations Act. Rather than imposing this obligation on licensees, ASIC should make it clear to investors bidding into bookbuilds that they should conduct themselves in accordance with established norms that prohibit engaging in conduct that is misleading or deceptive in trade or commence. In this respect, it should be sufficient to rely upon the bidding rules that apply to bookbuild processes. These rules typically follow the conventions established by the Australian Financial Market Association's Equity Capital Markets Master Terms and expressly provide that bids are binding, and capable of acceptance in full, on close.

  If this guidance in item (e) of section E1 is to remain, we would ask the Commission to consider narrowing it to make it clear that the exclusion of 'excessive' bids applies only to bids where it is clear there is manifest error.

- **Bookbuild messaging** – on bookbuild messaging itself, we make the below observations:
  - We expect that the Commission's aspiration of equality of timing and information in item (b) of section E1 is likely to create time zone and practical issues for some licensees. In our experience, there are a variety of practices amongst licensees as to how bookbuild messages are

distributed and these are generally tailored to the relevant offer jurisdictions and any applicable regulatory requirements in the places where distribution takes place – in particular, for example, to comply with a local law requirement that any sales be made by a locally registered licensee. Noting this, we would suggest that more flexibility be included in item (b) of section E1 to take into account the global nature of bookbuilds.

- The suggestion in item (e) of section E1 that bids from related investment managers and principal accounts should be excluded from coverage messages is likely to give rise to the very concern that ASIC is seeking to manage, that is, contributing to the opacity of the bookbuild process. It is not clear why demand from a related investment manager, who would typically be a licensee or owe fiduciary duties to third party accounts or third-party funds, should be excluded. For the reasons outlined below, we also disagree with the suggestion that principal account demand creates an intractable conflict and should be excluded. Given investors have explained to ASIC that the coverage message is the key message they are looking for (refer to paragraph 172), the failure to incorporate this demand in the assessment of this type of message could adversely impact the success of the transaction for the issuer and potentially impact the integrity of the book.

- **Allocations to connected parties** – the BLS supports the comments made in section F of Report 605 with respect to employee allocations. We do however think that the "better practices for licensees" in F2 is too restrictive in respect of principal bids and may operate to the detriment of issuers.

  In many cases, the licensee's principal desks submitting this demand have their own mandates and investment thesis. While we recognise the perception of, or potential for, a conflict, it is one that can be managed, as opposed to being eliminated. Provided the allocation is made with full visibility to the issuer, in a manner consistent with the issuer's objectives and made on the same basis as other comparable investors, then this should be sufficient. We do not believe that there should be any requirement to impose a minimum hold period (which is difficult to assess) or require separate disclosure of the actual allocation to investors.

- **Settlement underwriting** – it is unclear to the BLS what paragraphs 225 and 226 are doing in Report 605. Perhaps they are in some way related to the observation in paragraph 103 about allocation recommendations being similar irrespective of the type of underwriting. We have found no other connection, nor any reason for inclusion.

  As this is a multi-faceted issue, it may be best for the BLS to meet with the Commission to discuss as it would be inappropriate not to comment on this given it sits at the end of a document that is unrelated to settlement underwriting.

- **Debt capital markets transactions**: We caution against simply translating the findings and proposed practices in Report 605 to institutional debt raising transactions. In our experience, these transactions generally adhere to international norms and practices that provide proper protections for the institutional market. While we welcome ASIC's interest in this topic, we would recommend that ASIC undertake a broad consultation with stakeholders before stipulating any alternative practice guidance.

If the Commission wishes to discuss any of the observations in this letter, please feel free to contact David Friedlander and Amanda Isouard of King & Wood Mallesons (david.friedlander@au.kwm.com; amanda.isouard@au.kwm.com), Jeremy Williams of Goldman Sachs Australia Pty Ltd (jeremy.b.williams@gs.com) or Anne Murphy Cruise of Macquarie Capital (Australia) Limited (anne.murphycruise@macquarie.com).

Yours sincerely,

Rebecca Maslen-Stannage
Chair, Business Law Section