ASIC
Australian Securities & Investments Commission

REPORT 521

Further review of emerging market issuers

April 2017

About this report

This report provides key observations on regulatory issues relating to entities listed on Australian markets with substantial connection to emerging markets.

It refers to the challenges highlighted in Report 368 *Emerging market issuers* (REP 368) and discusses how ASIC has responded to some of those challenges.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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A Overview

Background

1 Many entities listed on Australian markets operate beyond Australia. The global economy provides opportunities for entities to leverage new markets to produce, acquire or sell their goods or services, or to raise capital. Listed entities with a strong connection to one or more emerging markets have been common in our capital markets for some time. As well as opportunities, these connections can present challenges for our markets, which could have an adverse impact on investor confidence.

2 To ensure that the reputation of our markets is maintained, we have continued to monitor activity by emerging market issuers. This follows our review in 2012–13, which considered the impact of such entities on our markets' overall integrity. The outcome of our review was published in Report 368 *Emerging market issuers* (REP 368).

3 We continue to see many of the challenges identified in REP 368 as particularly relevant to emerging market issuers, including those relating to:

(a) implementing good corporate governance in light of a geographically scattered board with limited financial resources;

(b) implementing effective internal controls and risk management systems where operations are geographically diverse;

(c) operating through complex ownership or contractual arrangements in response to laws in some jurisdictions that limit the ownership of assets by foreign entities;

(d) relying on one or two key individuals located outside Australia, which raises the risk of substantial transactions benefiting those individuals; and

(e) ability of a company or its auditor to verify information or opinions about the entity's operations and performance provided by experts or professionals in an overseas jurisdiction.

4 ASIC's work in relation to the risks posed by emerging market issuers furthers our regulatory strategic priorities of:

(a) investor and financial consumer trust and confidence; and

(b) fair, orderly, transparent and efficient markets.

5 Actions so far by ASIC have ensured that the presence of these entities has had minimal negative impact on the confidence of investors and the integrity of our markets. We have sought to provide greater transparency around the risks associated with emerging market issuers in a multi-faceted way, through engagement with industry and stakeholders, surveillance, enforcement action,

guidance, education and policy advice. As part of our broader regulatory objective, we have undertaken a number of regulatory initiatives to address topical issues in our markets, which have also had a direct impact on our oversight of emerging market issuers.

What is an 'emerging market issuer'?

6 We consider an 'emerging market issuer' to be any listed entity that:

(a) is incorporated in an emerging market; or

(b) has a significant exposure or strong connection to an emerging market through its business operations, shareholders or its board or management.

Note: See Key terms for a detailed definition of 'emerging market issuer'.

7 Since REP 368, we have continued to develop what we consider to be an 'emerging market' to include Eastern Europe, Asia and the Pacific (excluding Singapore, Hong Kong, Japan and New Zealand), Africa, South America, Mexico, Central America, the Caribbean or the Middle East. We will also have regard to the list of developing countries declared by the Minister for Foreign Affairs for the purposes of the Overseas Aid Gift Deduction Scheme established by the *Income Tax Assessment Act 1997* when determining what an emerging market is.[1] This is consistent with ASX's approach.

Purpose of this report

8 This report discusses ASIC's views on emerging market issuer activity in our markets. It also highlights how ASIC has responded to some of the key challenges identified in REP 368 that we have continued to see in our markets—in particular:

(a) Section B highlights and discusses key statistics and observations gathered from our work in the regulation of emerging market issuers.

(b) Section C focuses on issuers. We discuss the importance of good corporate governance and the need for issuers to understand their Australian legal obligations when, for example, conducting fundraising transactions. It also highlights our enforcement action in relation to some issuers.

(c) Section D focuses on gatekeepers' conduct, as well as their fundamental responsibility to uphold the confidence of investors by ensuring that issuers understand the Australian regulatory regime and their obligations.

[1] Department of Foreign Affairs and Trade, *List of Developing Countries as declared by the Minister for Foreign Affairs*, 17 February 2015.

ASIC's next steps

9 In performing our role in regulating the Australian markets, we will continue to consider the risks associated with emerging market issuers through our day-to-day responsibilities. We will continue to conduct our usual regulatory activities and, where appropriate, take enforcement action in this area.

10 Our work will aim to ensure that:

(a) existing issuers and those seeking to enter our markets abide by our rules; and

(b) gatekeepers who are responsible for advising and assisting emerging market issuers do so in a way that upholds the integrity of our markets.

B Key statistics and observations

Key points

Emerging market issuers remain prevalent in our markets as we see new listings and consistent levels of corporate finance transactions by these entities.

This section highlights and discusses key statistics and observations gathered from our work in regulating emerging market issuers, with a focus on fundraising transactions and the composition of our markets.

Fundraising transaction statistics and observations

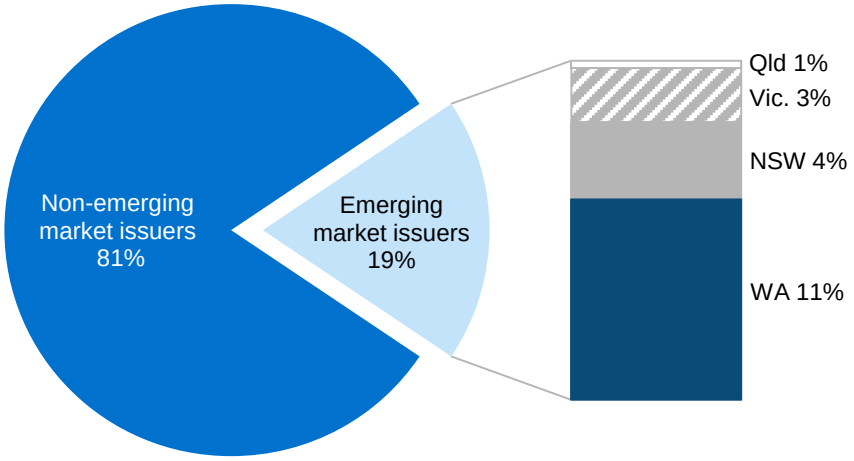
11 Financial markets facilitate the raising of capital and the efficient allocation of resources and risks. Emerging market issuers who seek to list on our markets and raise capital from retail investors can pose a heightened risk to the market's reputation if the issuer is not appropriately managed and fails to comply with Australia's legal and regulatory regime.

12 To obtain listing, emerging market issuers are required to lodge a disclosure document with ASIC under Ch 6D of the *Corporations Act 2001* (Corporations Act), which is subject to our review. This is often an issuer's first engagement with ASIC and is a critical hurdle before they are able to access retail capital.

13 ASIC plays an important role in endeavouring to ensure that offers made in our jurisdiction comply with the law. Our review of prospectuses for emerging market issuers is an opportunity for us to not only see that all information that an investor could reasonably require is presented in the document, but also to understand whether the board has the appropriate expertise to provide oversight of the company in accordance with Australia's regulatory regime.

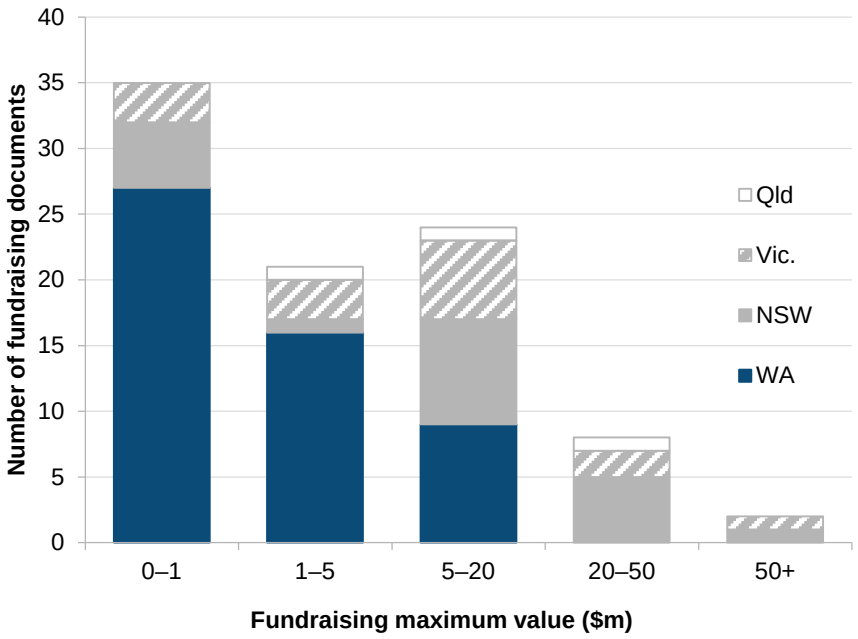
14 In the period from 1 January to 31 December 2016, 19% of documents lodged with ASIC by companies either listed or seeking a listing were lodged by emerging market issuers. Western Australia stood out as the region with the greatest number of transactions by emerging market issuers, although at the smaller end of the market in terms of transaction size.

Figure 1: Fundraising documents (January to December 2016)



Note: See paragraph 104 in the appendix for the data shown in this figure (accessible version).

Figure 2: Fundraising documents from emerging market issuers by value (January to December 2016)



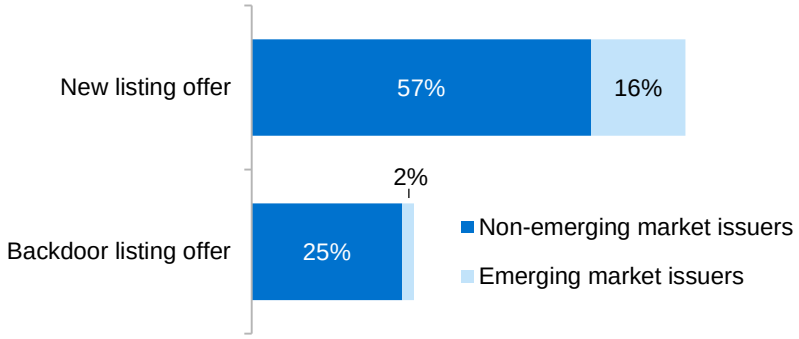
Note: See Table 2 in the appendix for the data shown in this figure (accessible version).

15 Overall, the pattern of disclosure document lodgements was similar for emerging market issuers and non-emerging market issuers. Documents prepared for new listing offers and backdoor listing offers made up 40% of the fundraising documents lodged by emerging market issuers (as compared to

approximately 44% for non-emerging market issuers).[2] Of these, 11% of emerging market issuer listings were structured as backdoor listings (as compared to 31% of non-emerging market issuer listings).

16 Figure 3 shows a breakdown of the initial offer documents by type of offer and type of issuer. Of all initial offer documents, 73% were for new listing offers (including 16% from emerging market issuers) and the remaining 27% were for backdoor listing offers (2% being from emerging market issuers).

Figure 3: Types of offer for initial offer documents (January to December 2016)



Note: See Table 3 in the appendix for the data shown in this figure (accessible version).

17 Our review revealed that:

(a) ASIC raised concerns in approximately 20% of documents lodged by emerging market issuers, which was consistent with non-emerging market issuers.

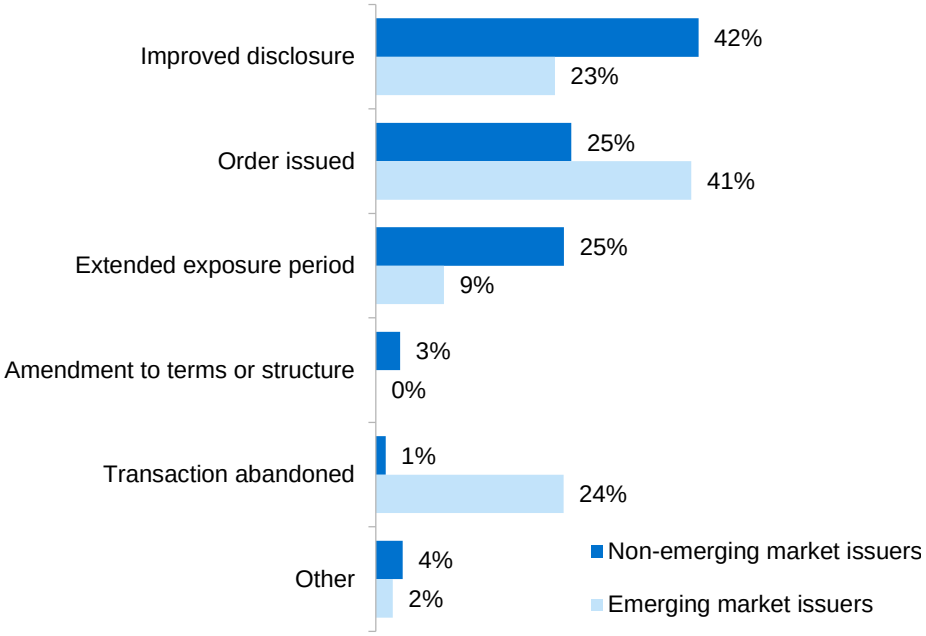
(b) ASIC generally raised a greater number of comments in emerging market issuer documents than non-emerging market issuer documents.

(c) The nature of concerns identified for emerging market issuers was largely in line with those raised for non-emerging market issuers, with a slightly greater emphasis on financial information disclosures. Please refer to paragraph 29 for further information.

[2] Fundraising documents include disclosure documents lodged by already listed entities under s713 and other compliance disclosure documents and mutual recognition documents.

18 The outcomes of our fundraising document reviews are set out in Figure 4.

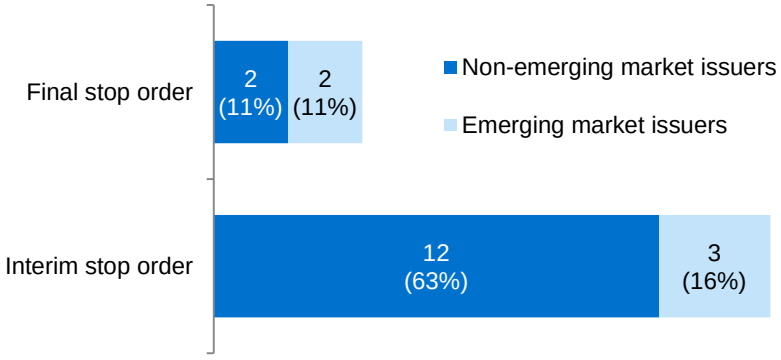
Figure 4: Outcomes of fundraising document reviews



Note: See Table 4 in the appendix for the data shown in this figure (accessible version).

19 Emerging market issuers were more likely than non-emerging market issuers to receive an interim or final stop order. Emerging market issuers received 27% of all orders (see Figure 5 below) while only accounting for 19% of lodged documents (see Figure 1 above). Final stop orders issued to emerging market issuers included two to China based companies, being a gold mining company and a financial technology company (blockchain technology).

Figure 5: Orders by issuer type (January to December 2016)



Note: See Table 5 in the appendix for the data shown in this figure (accessible version).

Market statistics and observations

Emerging market issuers listed on ASX

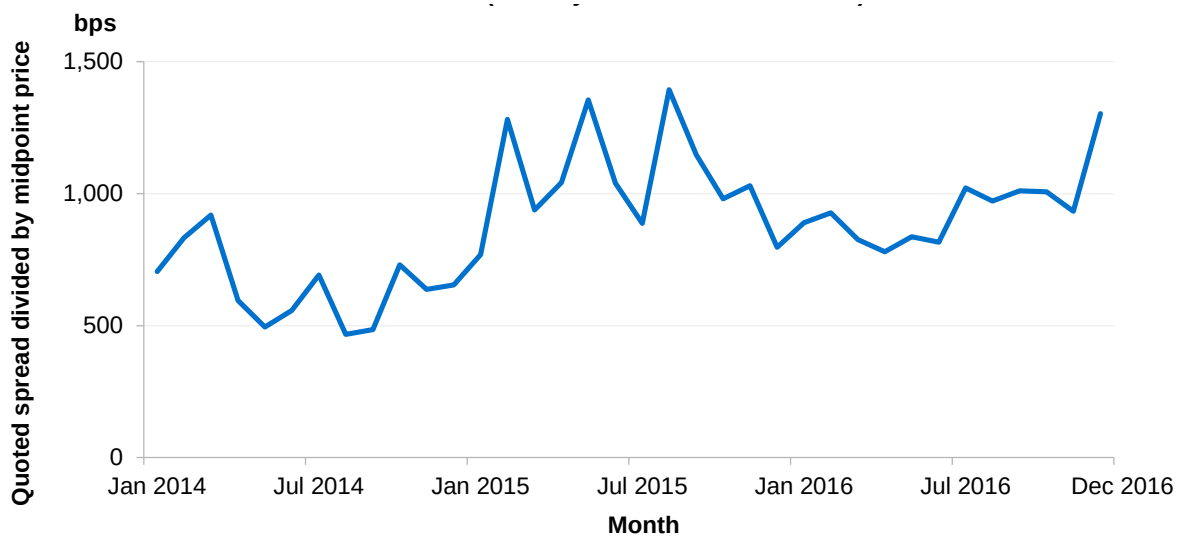
20 In the period from 1 July 2013 to 31 December 2016, we identified 57 new emerging market issuer listings on ASX conducted by way of an initial public offering (IPO) or backdoor listing.

21 Issuers from Asia, mostly from China, represented the greatest number of emerging market issuer listings, with 46 of 57 new listings being from Asia. The balance of new emerging market issuer listings were made up of a small number of African, Pacific Island and European based issuers.

22 Based on a sample review of new emerging market issuers listed on ASX from 1 July 2013 to 30 June 2016, we noted a general lack of liquidity, with emerging market issuer securities trading on 48% of trading days. On the days where trading occurred, an average of 18.5 trades were placed.

23 This lack of liquidity is further illustrated by the median quoted bid–ask spread for new emerging market issuer listings from 1 July 2013 to 31 December 2016. During the period from 1 January 2014 to 31 December 2016, the quoted bid–ask spread for emerging market issuers listed on ASX (able to be traded on ASX and Chi-X) fluctuated between 400 and 1,400 basis points (see Figure 6). This is compared to a turnover-weighted average quoted bid–ask spread of between 19 and 26 basis points for all securities listed on ASX (able to be traded on ASX and Chi-X) for the same period.

Figure 6: Median quoted bid–ask spread for emerging market issuers able to be traded on ASX and Chi-X (January 2014 to December 2016)



Note 1: See paragraph 105 and Table 6 in the appendix for the data shown in this figure (accessible version).

Note 2: Given the small sample and high variability in quoted spread among emerging market issuer securities, the median (rather than simple or weighted average) quoted bid–ask spread has been used in this report.

Note 3: The period from July to December 2013 was excluded from this analysis due to data quality issues.

Note 4: ASIC does not have relevant data to perform similar analysis for emerging market issuer securities listed on NSX and SSX.

Emerging market issuers listed on NSX and SSX

24 As at 31 December 2016, we identified 19 emerging market issuers (based on the location of operation) listed on NSX and five emerging market issuers on SSX (being all listings on SSX). As with the sample of new emerging market issuers listed on ASX, issuers from Asia represented the greatest number of emerging market issuers listed on NSX. All entities listed on SSX are from Asia.

Table 1: Prevalence of emerging market issuers on NSX and SSX

Exchange	Number of emerging market issuers	Emerging market issuers as % of all listings	Number of Asia-based emerging market issuers	Asia-based emerging market issuers as % of all listings
NSX	19	25.3%	15	20%
SSX	5	100%	5	100%

25 Emerging market issuer securities on NSX and SSX are also highly illiquid. During the period from 1 July 2013 to 30 June 2016, we identified that:

(a) emerging market issuer securities traded on NSX on 4% of trading days, with an average of 1.3 trades placed on the days that trading occurred; and

(b) emerging market issuer securities traded on SSX on 12% of trading days, with an average of 2.9 trades placed on the days that trading occurred.

C Issuer obligations

Key points

It is important for issuers to be aware of their obligations when raising capital in Australia, as good corporate governance is fundamental in promoting investor confidence.

We have continued to see emerging market issuers who appear to be insufficiently aware of their legal obligations under the Corporations Act, particularly relating to corporate governance, conflicts of interest, disclosure and financial reporting.

We have undertaken a number of regulatory initiatives to address some of the challenges faced by emerging market issuers, with a focus on disclosure in fundraising transactions and general corporate governance.

This section provides a summary of the regulatory initiatives undertaken by ASIC to raise awareness among issuers about appropriate market practice.

Disclosure obligations in an initial public offering

Review of disclosure documents

26 Before listing on an exchange, companies will usually undertake a retail offer process that requires preparation of a disclosure document, such as a prospectus.

27 The purpose of the disclosure document is to help retail investors assess the risk and returns associated with an offer of securities for issue or sale and make informed investment decisions. We review disclosure documents to assess their compliance with Ch 6D of the Corporations Act, including the requirements that the prospectus contain all information a retail investor and their professional advisers would reasonably require to make their decision.

28 ASIC also has the power to place interim and final stop orders on a disclosure document, which prevents the issue of securities if we have concerns that disclosure is inadequate.

29 In the 2016 calendar year, the top five concerns identified in disclosure documents lodged by emerging market issuers were the same as those for non-emerging market issuers, being concerns about:

(a) adequate disclosure of business model;

(b) use of funds;

(c) risks;

(d) misleading and deceptive disclosure; and

(e) disclosure that was not clear, concise and effective.

30 However, concerns about financial information disclosure were more prevalent for documents prepared by emerging market issuers than those lodged by issuers generally.

31 Through our disclosure work we aim to ensure that investors fully understand the merits of the investment opportunity available to them and make decisions accordingly. For example, where an issuer's operations, rights to assets or corporate structure is subject to the law of a foreign jurisdiction, it has become common practice for those issuers to include a report from an independent solicitor or expert in their disclosure documents that explains the rights and risks associated with ownerships in those jurisdictions. For most capital raisings conducted by emerging market issuers, we now expect this type of information to be available for investors as it is information that an investor would reasonably require to make an informed decision about the prospects and position of an issuer.

32 We also work closely with Australia's exchanges and may raise concerns about potential listings or already listed entities. For example, using our market analysis intelligence systems, we detected unusual price movements in the shares of Fifth Element Limited soon after its trading began on ASX in 2014 and noted the apparent absence of selling interest in the shares notwithstanding the significant increase in price. Through our ongoing operational dialogue, ASIC was able to work with ASX to explore these concerns. The concerns caused ASX to suspend trading in Fifth Element Limited shares on 15 July 2014, pending a review of the company's satisfaction of conditions for admission to ASX. Fifth Element Limited was subsequently removed from ASX's official list on 24 April 2015.

Due diligence practices

33 Due diligence is a process adopted by issuers to determine whether they have properly prepared a prospectus when offering securities to retail investors. The process is designed to ensure the prospectus contains accurate information and has not omitted any material information.

34 Issuers of securities and their directors are responsible and liable for the information contained in the prospectus. It is important for these parties to engage in a robust and thorough due diligence process, supported by their advisers, to satisfy themselves that the information is accurate and complete and to enable issuers to rely on the key defences to prospectus liability provided in s731 and 733 of the Corporations Act.

35 Between November 2014 and January 2016, we conducted systematic reviews of the due diligence practices of 12 IPO issuers. These ranged from small to large offers, including a sample of offers from emerging market issuers. In the review sample, all emerging market issuers were based in China.

36 As a result of our due diligence reviews, in all but one instance the prospectus issuer was required to make corrective disclosure or amendments to the offer terms by issuing a replacement prospectus. One review resulted in the withdrawal of the offer, and another was subject to a final stop order.

37 For emerging market issuers, language and cultural barriers are a key risk and must be addressed to ensure that all directors are able to effectively participate in the IPO due diligence process and provide informed consent to the lodgement of the prospectus.

38 We published the results of our review in Report 484 *Due diligence practices in initial public offerings* (REP 484) in July 2016, including the following specific observations relevant to emerging market issuers:

(a) there was often no evidence of prospectuses and directors' questionnaires having been translated into Chinese for non-English speaking directors, even when the issue was mentioned in one of the board minutes;

(b) only one issuer produced board minutes in both Chinese and English;

(c) there were instances where Chinese material contracts and agreements were not translated into English, and board minutes were being recorded in English only, which raises questions about how the non-Chinese proficient directors are able to ultimately ensure that the information contained in the prospectus is accurate and free from material misstatement in circumstances where the due diligence committee has not commissioned any due diligence reports; and

(d) the involvement of the Australian directors, apparently appointed to satisfy the director residency requirements for an Australian public company, was superficial regarding the preparation of the prospectus.

39 We have continued to conduct due diligence surveillance to promote good due diligence practices and ensure that all material disclosure is given to investors.

Marketing material for initial public offerings

40 A prospectus is not the only communication with investors about an IPO. As the success of an offer of securities depends on investor interest, issuers will undertake a number of steps in connection with the IPO. This includes appointing a team of advisers, who together with the issuer will determine the marketing strategy for the IPO and sale of securities. Despite relying on others for some of the marketing activities, issuers themselves also have an obligation to ensure that the marketing of their offer is conducted in accordance with the law.

41 We undertook a more targeted review of the marketing practices for IPOs by issuers and advisers, which is discussed in more detail in section D. In some

instances, emerging market issuers were found to have engaged in problematic marketing practices.

Corporate governance

42 Good corporate governance is fundamental in promoting investor confidence. A robust corporate governance framework enables companies to establish appropriate systems and processes to dictate how authority within an entity is exercised or controlled.

43 In particular, directors play an important ongoing role as gatekeepers of transparency and accountability in the major financial and business dealings of an entity. This means directors are required to remain active, informed and competent in the oversight of an entity.

44 Our review of emerging market issuers in 2012–13 identified a number of challenges to good corporate governance faced by emerging market issuers. The most common challenges included:

(a) geographically scattered boards with limited financial resources;

(b) complex ownership structures due to foreign legislative requirements; and

(c) reliance on key individuals who are not located in Australia.

45 We have continued to respond to corporate governance issues on a day-to-day basis. In one instance, we engaged with the board of an emerging market issuer to ensure that, following a number of board vacancies, the newly appointed board members had the appropriate experience and expertise to manage an Australian-listed entity.

46 We have also taken formal action against entities for poor corporate governance, including action against three companies listed on SSX for allegedly failing to comply with continuous disclosure obligations.

47 Some of the other actions taken are detailed below.

Complex corporate structures

48 In 2015, we took action to address the use of complex corporate structures such as variable interest entity structures (also known as VIE structures) by emerging market issuers from China. As discussed in Report 469 *ASIC regulation of corporate finance: July to December 2015* (REP 469), variable interest entity structures were developed as a means to avoid the foreign investment restrictions on certain industries in China through a series of complex contractual arrangements between the Chinese operating company and the foreign listed company.

49 We had serious concerns about the enforceability of these contractual arrangements, particularly in the face of an uncertain regulatory environment in China. As a result of these concerns ASX, NSX and SSX have agreed to adopt a moratorium on IPOs of companies with such complex structures.

Enforcement action

Sino Australia Oil and Gas Limited

50 In 2014, we commenced an investigation into Sino Australia Oil and Gas Limited (Sino Australia), which was listed on ASX on 12 December 2013 after raising approximately $13.6 million under an IPO.

51 We commenced civil proceedings against Sino Australia and its former chairman, Mr Tianpeng Shao. We alleged that:

(a) the company had breached its continuous disclosure obligations and made misleading and deceptive statements in its prospectus during 2013; and

(b) Mr Shao had failed to act with the proper degree of care and diligence as a director and breached continuous disclosure laws.

52 On 8 December 2016, the Federal Court of Australia ordered that:

(a) Sino Australia pay a pecuniary penalty of $800,000;

(b) Mr Shao be disqualified from managing corporations for a period of 20 years; and

(c) on application by the liquidator of Sino Australia, Mr Shao pay compensation to Sino Australia of $5,539,758 (being the company's estimated liability to shareholders).

53 In making the declarations, the court found that Sino Australia:

(a) made false representations in its prospectus documentation about patents that it claimed it and its Chinese-based subsidiary held;

(b) failed to disclose that its profit forecast for the 2013 calendar year would be significantly less than forecast in its replacement prospectus;

(c) failed to disclose in its prospectus documents the existence of a loan agreement with the sole director of Sino Australia's Chinese-based subsidiary;

(d) made misleading and deceptive statements in its prospectus about the existence of service contracts it claimed to hold in China;

(e) made misleading or deceptive statements in relation to a claim that it had received a sum of $3.1 million from the proceeds of convertible notes; and

(f) provided false information to its auditors about a Chinese-based subsidiary.

54 In relation to Mr Shao, the court found that he:

(a) was involved in the contraventions committed by Sino Australia;

(b) failed to inform himself about Sino Australia's disclosure requirements and failed to understand Sino Australia's prospectus; and

(c) had attempted to transfer $7.5 million from Sino Australia's Australian bank accounts to accounts in China for the purpose of advancing a loan to a Chinese-based subsidiary in circumstances where the loan would have been irrecoverable.

55 In making the orders against Mr Shao, Justice Davies said:

> Mr Shao's explanation was that he did not understand Australia's legal requirements. If he did not understand Australia's legal requirements, his lack of knowledge demonstrated a lack of diligence and care by him in informing himself properly and fully about the company's legal obligations and a serious lack of appreciation of the importance of continuous disclosure.

Sino Strategic International Limited

56 In July 2015, the Federal Court of Australia made orders to freeze the assets of Sino Strategic International Limited (Sino Strategic) and wind up the company following a number of serious and consistent failures to lodge its annual financial reports, report to members and hold annual general meetings, as well as its failure to comply with board composition obligations under the Corporations Act such as the requirement to have two directors resident in Australia and the requirement to have a company secretary.

57 We made the application to the court for winding-up and freezing orders because of concerns that:

(a) Sino Strategic had been involved in multiple contraventions of the Corporations Act and it was not complying with its obligations under that legislation;

(b) the affairs of Sino Strategic had not been properly managed for some time and the assets of the company were at risk; and

(c) Sino Strategic's continued failure to comply with the basic regulatory requirements of a listed company was contrary to the interests of the company's shareholders.

58 In making the wind-up order, the court found that Sino Strategic had contravened a number of important provisions of the Corporations Act, that Sino Strategic was not conducting any business in Australia and that one of its Chinese directors, without reasonable explanation, had attempted to secure control of the only real asset left in Australia.

D The role of gatekeepers

Key points

Gatekeepers play an important role in protecting investors, fostering fair and efficient capital markets, and creating and maintaining confidence in capital markets.

Gatekeepers rely on their reputations to generate work and so should be incentivised to work towards the long-term success of companies for which they act.

It is important that clients understand the Australian regulatory regime when seeking investment from our market. As such, a significant part of the role of gatekeepers is to guide issuers about the law and market expectations of their behaviour.

This section highlights the role of some key gatekeepers, including legal and financial advisers, auditors, exchange operators, sponsors and market participants in upholding the trust and confidence of our markets. It also provides a summary of key regulatory initiatives undertaken by ASIC in relation to the conduct of such gatekeepers.

Advisers in initial public offerings

59 Legal and financial advisers (including underwriters) play a crucial role in advising issuers on appropriate conduct during an IPO.

Due diligence process

60 Issuers will often engage expert advisers to conduct the due diligence process when preparing for an IPO. The due diligence process is mainly driven by legal advisers. However, issuers also engage investigating accountants, tax advisers, underwriters or lead managers.

61 Due to the heightened risks associated with emerging market issuers, Australian advisers play a particularly important role in providing effective oversight and applying sufficient scepticism of the due diligence work carried out by foreign legal and other advisers. Australian advisers should make sure that they understand the political and cultural environment in which the issuer operates, local business practices affecting the issuer, local laws affecting the issuer and the issuer's local expert advisers. Without this understanding it is difficult to effectively ensure that the due diligence process identifies all material issues and prevents misleading disclosure.

62 In addition to the general recommendations in REP 484, we made a number of recommendations specific to advisers of emerging market issuers during the due

diligence process. In particular, we recommended that the Australian legal advisers should ensure that:

(a) the foreign advisers meet the qualitative and quantitative materiality thresholds agreed by the due diligence committee and have regard to these thresholds to properly carry out the due diligence inquiries;

(b) the foreign legal advisers have sighted signed, original documents;

(c) the foreign legal advisers have made independent inquiries, provided evidence of those inquiries and independently verified the information provided by the issuer to an appropriate level of independent and objective evidence;

(d) the foreign legal report does not make assumptions about issues that are important for disclosure (e.g. assume that the issuer has legal title over certain material assets without independent verification);

(e) the foreign legal report provides details about the types of documents reviewed, including a summary of all the key material terms of those agreements or contracts; and

(f) the foreign legal report clearly sets out the basis on which its opinion has been formed about whether the agreements or contracts are valid and enforceable under the relevant foreign laws and regulations.

ASIC's review of marketing practices in IPOs

63 We monitor the marketing of IPOs as part of our usual prospectus review process and consider that the way an IPO is marketed to an investor may have an impact on their investment decision.

64 We have recently seen some instances where the marketing material for an IPO by an emerging market issuer misstated ASIC's role in the IPO process, including statements that ASIC had granted listing approval on the relevant securities exchange and that ASIC had approved prospectuses. These misstatements were made both in English and in a language other than English and were found in banner advertisements on a firm's website, in newspapers and website advertisements for the IPO, and on social media platform WeChat.

65 We were concerned that the implication that ASIC had considered the merits of the offer and approved it might have influenced retail investors to invest. In each instance, we took regulatory action to have the issuer correct these misstatements on the relevant websites and publications.

ASIC's targeted review

66 We undertook a targeted review of marketing practices by advisers for IPOs. The review focused on the online and social media marketing to retail investors for 23 IPOs where a prospectus was lodged. We also conducted a more extensive review of the marketing practices and materials of 17 firms that were

involved in seven of the original 23 IPOs. Our review included a number of higher-risk IPOs including emerging market issuers, so that we could assess how the marketing practices differed from other issuers.

67 Report 494 *Marketing practices in initial public offerings of securities* (REP 494) details our findings from the review, highlights areas of concern and provides recommendations to improve marketing practices for IPOs in the future. REP 494 makes the following specific observations about the marketing of IPOs by emerging market issuers and their advisers:

(a) Emerging market issuers used retail roadshows, print advertisement through Australian foreign language newspapers, and platforms that directly link investors to issuers such as OnMarket BookBuilds, where an issuer directly engages the services of OnMarket BookBuilds and pays OnMarket BookBuilds a fee for successful allocations.

(b) Marketing of IPOs of emerging market issuers was generally targeted to investors originating from the home jurisdiction of the emerging market issuer. A lot of the marketing material was prepared in a language of the relevant emerging market of the issuer. This may present challenges for firms trying to ensure consistency between the contents of the prospectus and the marketing material.

68 In our review, we observed one instance where firms marketed an IPO of an emerging market issuer to investors based on factors that were not connected to the merits of the individual IPO. In particular, we saw communications between firms' employees and clients in relation to the IPO where spread was the only or key discussion point for the investment. These communications included statements in emails where the firm was asking investors to assist with spread, and either proposed to put the investor in and take them out at a later stage, or stated that there would be sufficient demand after listing to release the investor from their position.

69 ASIC considers that:

(a) if they are targeting investors from a non-English speaking background, advisers should ensure that communications are clear and accurate (including any statements about the regulatory frameworks in Australia and about ASIC's role);

(b) if marketing material is being produced in a language other than English, advisers should ensure that they fully understand the material which may include getting translations before publication (if necessary); and

(c) marketing an IPO primarily on the basis of asking investors to assist with meeting spread requirements, or by using comparisons with other successful IPOs the firm was involved in, are risky practices. Statements that an investor can invest and be taken out at a later stage (inferring that there is no risk of loss to the investor), comparisons between IPOs, and

statements that purport to link IPO performance with a particular firm, may mislead investors in making the decision to invest.

Exchange operators

70 Exchanges provide essential market infrastructure to support the confidence of all market users and ensure that market activity takes place within a structured, reliable, fair and transparent environment. Exchange operators perform an important gatekeeper role, by actively administering the qualification process for listing and ensuring that listed entities meet their ongoing obligations to investors under the listing rules.

71 ASIC plays a fundamental role in setting the rules and framework for financial market activity in Australia through approving market rules, supervising compliance in those markets with the Corporations Act and market integrity rules, and conducting surveillance of all trading on the ASX, Chi-X, NSX and SSX markets.

72 ASIC also has the power to conduct periodic assesments of an exchange's activities to ensure compliance with their obligation to monitor and enforce their listing and operating rules.

Importance of listing standards

73 Listing standards (i.e. the listing rules together with how the rules are administered) provide an important framework that an exchange operator uses to consider whether an entity is appropriately qualified to access capital through that public market.

74 The importance of robust listing standards for Australian investors is underscored by the fact that Australians have one of the highest levels of equity ownership in the world.[3] One of the reasons why foreign investors choose to invest in the Australian equity market is our reputation for having a trusted, robust and transparent regulatory environment. Foreign investors are responsible for approximately 44.6% of all investment in our equity market,[4] which shows the global nature of investors in our markets and the confidence that foreign investors have in it.

75 In addition, technology and wide-scale adoption of social media by investors and listed entities is significantly reshaping how investors invest in markets and the role that listing standards have traditionally played in that process. For

[3] In October 2014, around 36% of all Australian adults (almost 6.5 million Australians) owned listed investment products, of which equities made up a significant proportion. See ASX, *The Australian share ownership study* (PDF 1.2 MB), June 2015.
[4] Australian Bureau of Statistics (ABS), 5232.0—Australian national accounts: Finance and wealth, March 2015, table 47.

instance, we are seeing a trend of investors relying more on their own independent internet research of an investment and using electronic service providers that offer direct access to the market rather than using full service brokers. This emphasises the importance of the gatekeeper function that listing standards fulfil, when issuers are making available investments that Australian retail investors can access with the click of a button.

Review of listing standards

76 As outlined in section B, there has been a growing trend in entities with very little connection to Australia seeking and obtaining listing here, particularly entities from emerging markets. This increasing number of listed emerging market issuer requires adjustments to the way exchanges have historically monitored compliance with their listing rules.

77 Following concerns about a number of listings from the smaller end of the market, including emerging market issuers, we commenced a review of the listing standards of Australia's domestic listing markets in the 2015 calendar year.

78 Some key observations from our assessments that are relevant to how exchanges can improve their standards, and at the same time tackle issues raised by emerging market issuers, are outlined below:

(a) Exchanges need to ensure they have appropriate arrangements to consider whether an entity is suitable for listing, including verifying whether management have suitable experience and integrity and whether the entity can demonstrate sufficient investor interest, through a legitimate and auditable level of spread, to enable secondary market liquidity.

(b) Exchanges should also ensure sufficient transparency, both internally and externally, about what constitutes 'suitability' for the purposes of admitting entities to their list.

(c) Exchanges must have processes to require frequent monitoring of compliance by emerging market issuers with relevant disclosure obligations, including monitoring news that may emanate from the entity's home jurisdiction or other sources.

(d) Timely disclosure of the financial performance of listed companies is crucial to fair, orderly and transparent markets, as is an exchange's ability to monitor and enforce its listing rules to ensure appropriate disclosure is made. Where appropriate disclosure is not made, an exchange should have processes in place to ensure entities are educated and, if necessary, sanctioned.

(e) With technology making it easier to invest, and with many emerging market issuer listings having shareholder bases predominantly from their respective home jurisdictions, it is important that exchanges are ever

vigilant. They must have processes in place to monitor price movements and, where appropriate, issue price queries and make inquiries of traders to rule out manipulation or other illegal conduct.

(f) Exchanges need to have in place structural and procedural controls to ensure that actual or perceived conflicts that may arise in the administration of their listing standards are robustly managed. This is particularly the case where other entities owned or controlled by the owner of an exchange play a commercial role in introducing companies to the exchange or are relied upon by the exchange to identify whether entities for listing are genuine.

79 Our assessment of SSX's listing standards raised important matters about the unique conflicts that have arisen in SSX's ownership and business model. Following our review, we recommended that a delegate of the Minister impose additional conditions on SSX's Australian market licence to ensure SSX has appropriate arrangements in place to meet its statutory obligations, particularly those about managing its conflicts and having suitable arrangements to monitor and enforce its listing standards.

Good practice listing principles

80 As a result of our review of listing standards, we have outlined some good practice principles that we consider would assist all operators (and prospective operators) of Australian listing markets to ensure that listing standards continue to support fair, orderly and transparent markets. These principles were first published in Report 480 *Assessment of ASX Limited's listing standards for equities* (REP 480) and updated in Report 518 *Assessment of Sydney Stock Exchange Limited's listing standards* (REP 518).

81 Based on our observations, good practice listing standards are made up of:

(a) effective listing rules that appropriately deal with admissions and ongoing criteria; and

(b) a robust and substantive approach to the monitoring and enforcement of those listing rules.

82 Good practice listing standards include ensuring:

(a) appropriate standards for listing such as for quality, size and operations that are consistent with the expectations of a listed entity in the Australian financial market;

(b) an entity can demonstrate that sufficient working capital is available to achieve its business objectives;

(c) an entity can demonstrate effective governance such that its directors, management and systems are sufficiently robust and have the relevant experience required to support the obligations of a listed entity;

(d) the entity's reasons for accessing the Australian capital market are to raise capital to support genuine business plans for growth and innovation; and

(e) the entity can demonstrate genuine and robust investor interest at the point of listing.

83 Good practice listing standards also include having appropriate administration practices in place including, for example, arrangements to ensure good governance and sufficient resourcing.

Exchange responses

84 ASX reviewed its requirements for admission to its list and proposed a number of changes, which came into effect in December 2016. According to ASX, the changes will enable it to continue to be a market of quality and integrity and remain internationally competitive.

85 ASX also made changes to its listing admission governance process, including:

(a) implementing an admissions pre-vetting process to allow early engagement with entities seeking listing, to enable ASX to assess at an early stage whether the entity is likely to meet ASX's listing standards.

(b) changing its governance structure for oversight of its listing decisions. ASX has established a committee of senior management to assist in the review of listing applications that pose particular risks to the market. All applications from emerging market issuers are reviewed by this committee. All applications from entities that are incorporated, have their main business operations, or have a majority of their board or a controlling shareholder resident in an emerging or developing market are now reviewed by this committee.

86 ASX has also enhanced transparency to assist stakeholders to understand how ASX interprets and applies its listing rules. ASX publishes on a quarterly basis high-level reasons why it has declined certain listing applications.

87 ASX's improved listing standards have had the effect of preventing inappropriate emerging market issuers from listing and being able to access retail capital. For example, of the 24 listing applications rejected by ASX from 1 January 2016 to 31 December 2016, ten (42%) had primary assets or business operations located in emerging markets, with ASX not satisfied that the entity's structure and operations were appropriate for a listed entity.[5]

88 SSX has also introduced operational controls to support its compliance with its statutory obligations in the future.

[5] ASX, *Listing and waiver applications declined by ASX: 1 January 2016 – 30 June 2016* (PDF 0.5 MB), *Listing and waiver applications declined by ASX: 1 July 2016 – 30 September 2016* (PDF 0.4 MB) and *Listing and waiver applications declined by ASX: 1 October 2016 – 31 December 2016* (PDF 0.4 MB).

89 At the date of this report, we have also conducted an assessment of NSX's listing standards. However, the outcome of our assessment is still being finalised.

Exchange-required nominated advisers

90 Some smaller exchanges in Australia and overseas require that prospective listees appoint an exchange-approved adviser to assist the entity during the listing process, and also with ongoing obligations upon listing. One of the reasons for this is that it assists non-Australian applicants/listees to familiarise themselves with the Australian regulatory, legal and governance environment.

91 For instance, NSX and SSX issuers are required to appoint a nominated adviser (or sponsor, in the case of SSX) to help the issuer's board with the application process and ensure that directors are aware of their responsibilities and obligations under the relevant listing rules. In the case of SSX, the sponsor is also expected to corroborate the integrity of the listee's information.

92 These nominated advisers play an important role in guiding issuers, particularly those from emerging markets who do not understand the Australian legal and regulatory regime. Nominated advisers should be cognisant of their obligation to ensure that issuers act in a compliant manner.

Market participants

93 We regard market participants as important gatekeepers of our markets. They perform a crucial role in ensuring that markets are fair, orderly and transparent, particularly in the context of monitoring trading in emerging market issuers' securities.

94 As emerging market issuers are more well-known to overseas investors where their business operations or controlling shareholders are based, trading in their securities usually has a very high participation by overseas investors.

95 High overseas investor participation has made it more difficult and more resource intensive for ASIC to investigate market misconduct in relation to trading in emerging market issuers securities, as often ASIC does not have jurisdictional reach over entities based overseas. Moreover, these securities are generally more vulnerable to market misconduct because of their smaller market capitalisation, higher shareholder concentration and lower liquidity.

96 We will often look to disrupt any potential or developing market misconduct together with market participants as soon as it is identified. We regularly contact relevant market participants to discuss our observations and concerns regarding any identified market misconduct.

97 We remind market participants of their obligations under the relevant market integrity rules, in particular the rules around their obligations to prevent manipulative trading. We also expect the market participants to work cooperatively to address potential misconduct, which includes sending questionable or otherwise unusual orders to a designated trading representative for review before they are sent to the market, or terminating trading access of the accounts if questionable or suspicious trading continues.

Auditors

98 Auditors have a crucial role to play as gatekeeper to provide independent scrutiny of a company's financial position and performance. Investors rely on auditors to provide independent assurance of the quality of financial reporting disclosure.

99 While ASIC regulates Australian-registered auditors, we do not regulate auditors outside of Australia and are unable to conduct a review of their work. As highlighted in REP 368, this may raise concerns for investors seeking to rely on the financial statements of an emerging market issuer.

100 Where an emerging market issuer is an Australian-incorporated entity but its business operations are overseas, the Australian auditor has responsibility for all components of the audit including the overseas operations. The Australian auditor can choose to rely on another auditor to audit the overseas components and in doing so, conducts a group audit in accordance with Auditing Standard ASA 600 *Special considerations—Audits of a group financial report (including the work of component auditors)*. In such circumstances, we do not have oversight of the work done by the group auditor in relation to the foreign asset.

101 The reliability of information supplied by key persons located in an emerging market (including the foreign auditor) remains a concern.

102 We remind auditors that where there are foreign operations or different auditors/experts in a group (particularly where auditors/experts are located in a foreign jurisdiction), additional scrutiny of the existence or value of the underlying assets may be necessary.

Appendix: Accessible versions of figures

103 This appendix is for people with visual or other impairments. It provides a text description and/or the underlying data for each of the figures included in this report.

Fundraising documents (January to December 2016)

Note: This text describes the data shown in Figure 1.

104 From January to December 2016, 81% of fundraising documents were lodged by non-emerging market issuers and 19% were lodged by emerging market issuers. Of the emerging market issuer fundraising transactions, 4% were in NSW, 3% were in Victoria, 1% were in Queensland and 11% were in Western Australia.

Return to Figure 1.

Table 2: Fundraising documents from emerging market issuers by value (January to December 2016)

Fundraising maximum value	New South Wales	Victoria	Queensland	Western Australia	Total
Less than $1 million	5	3	0	27	**35**
$1 million–$5 million	1	3	1	16	21
$5 million–$20 million	8	6	1	9	**24**
$20 million–$50 million	5	2	1	0	**8**
More than $50 million	1	1	0	0	**2**

Note: This is the data contained in Figure 2.

Table 3: Types of offer for initial offer documents (January to December 2016)

Type of offer	Emerging market issuers	Non-emerging market issuers
New listing offer	16%	57%
Backdoor offer	25%	2%

Note: This is the data contained in Figure 3.

Table 4: Outcomes of fundraising document reviews

Outcome	Emerging market issuers	Non-emerging market issuers
Improved disclosure	23%	42%
Order issued	41%	25%
Extended exposure period	9%	25%

Outcome	Emerging market issuers	Non-emerging market issuers
Amendment to terms or structure	0%	3%
Transaction abandoned	24%	1%
Other	2%	4%

Note: This is the data contained in Figure 4.

Table 5: Orders by issuer type (January to December 2016)

Order	Emerging market issuers	Non-emerging market issuers
Final stop order	2 orders (11%)	2 orders (11%)
Interim stop order	3 orders (16%)	12 orders (63%)

Note: This is the data contained in Figure 5.

Median quoted bid–ask spread for emerging market issuers able to be traded on ASX and Chi-X (January 2014 to December 2016)

Note: This text describes the data shown in Figure 6.

105 The median quoted bid–ask spread for emerging market issuers trading on ASX and Chi-X started at 705 basis points in January 2014 and traded between 467 and 919 basis points until January 2015. The median rose sharply in February 2015 (at 1,282 basis points), May 2015 (at 1,356 basis points) and August 2015 (at 1,394 basis points) and then traded between 780 and 1,148 basis points before finishing at 1,304 basis points in December 2016. The median for each month from January 2014 to December 2016 is provided in Table 6 below.

Table 6: Median quoted bid–ask spread for emerging market issuers able to be traded on ASX and Chi-X (January 2014 to December 2016)

Month	Quoted spread divided by midpoint price (bps)
January 2014	705
February 2014	833
March 2014	919
April 2014	595
May 2014	495
June 2014	558
July 2014	692
August 2014	467

Month	Quoted spread divided by midpoint price (bps)
September 2014	485
October 2014	730
November 2014	638
December 2014	655
January 2015	769
February 2015	1,282
March 2015	939
April 2015	1,042
May 2015	1,356
June 2015	1,040
July 2015	887
August 2015	1,394
September 2015	1,148
October 2015	981
November 2015	1,030
December 2015	797
January 2016	890
February 2016	927
March 2016	827
April 2016	780
May 2016	837
June 2016	816
July 2016	1,022
August 2016	972
September 2016	1,011
October 2016	1,007
November 2016	933
December 2016	1,304

Note: This is the data contained in Figure 6.

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
ASX	ASX Limited or the exchange market operated by ASX Limited
backdoor listing	A process where a person seeks to have an asset or business listed on an exchange by injecting the asset or business into an existing listed entity, rather than through the conventional process of applying to be admitted to the official list as a new entity
Ch 6D (for example)	A chapter of the Corporations Act (in this example numbered 6D)
Chi-X	Chi-X Australia Pty Limited or the exchange market operated by Chi-X Australia Pty Limited
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
emerging market	A jurisdiction in Eastern Europe, Asia and the Pacific (excluding Singapore, Hong Kong, Japan and New Zealand), Africa, South America, Mexico, Central America, the Caribbean or the Middle East
emerging market issuer	An entity is an emerging market issuer if: • the entity (or its parent entity if it is a wholly owned subsidiary) is incorporated in an emerging market; or • the entity (or its parent entity if it is a wholly owned subsidiary) has a significant exposure or strong connection to the emerging market through: – business operations, if a significant proportion of its revenue-generating assets are located in an emerging market; – shareholders, if its shares are dominantly held (i.e. at least 50%) by persons residing in an emerging market; or, where the shareholder is an entity, the shareholder is an emerging market issuer; or – board/management, if at least half of its board members reside in an emerging market
IPO	Initial public offering
NSX	NSX Limited or the exchange market operated by NSX Limited
REP 368 (for example)	An ASIC report (in this example numbered 368)
SSX	Sydney Stock Exchange Limited or the exchange market operated by Sydney Stock Exchange Limited
s731 (for example)	A section of the Corporations Act (in this example numbered 731)

Related information

Headnotes

advertising, advisers, firms, initial public offering, investors, IPO, issuers, marketing, due diligence, prospectus, emerging market issuers, emerging markets, corporate governance, disclosure, auditors, backdoor listings, listing rules, director, due diligence process, legal advisers

Legislation

Corporations Act 2001

Income Tax Assessment Act 1997

Cases

Australian Securities and Investments Commission, in the matter of Sino Australia Oil and Gas Limited (in liq) v Sino Australia Oil and Gas Limited (in liq) [2016] FCA 934 (11 August 2016)

Reports

REP 368 *Emerging market issuers*

REP 469 *ASIC regulation of corporate finance: July to December 2015*

REP 480 *Assessment of ASX Limited's listing standards for equities*

REP 484 *Due diligence practices in initial public offerings*

REP 494 *Marketing practices in initial public offerings of securities*

REP 518 *Assessment of Sydney Stock Exchange Limited's listing standards*

Standards

Auditing Standard ASA 600 *Special considerations—Audits of a group financial report (including the work of component auditors)*

ASX documents

Listing and waiver applications declined by ASX: 1 January 2016 – 30 June 2016 (PDF 0.5 MB)

Listing and waiver applications declined by ASX: 1 July 2016 – 30 September 2016 (PDF 0.4 MB)

Listing and waiver applications declined by ASX: 1 October 2016 – 31 December 2016 (PDF 0.4 MB)

The Australian share ownership study (PDF 1.2 MB), June 2015

Other documents

Australian Bureau of Statistics (ABS), 5232.0—Australian national accounts: Finance and wealth, March 2015

Department of Foreign Affairs and Trade, *List of Developing Countries as declared by the Minister for Foreign Affairs*, 17 February 2015

Media releases

14-324MR *Sino Strategic International Ltd fined for failing to lodge financials*

15-182MR *Court appoints liquidator to Sino Strategic*

16-255MR *Court finds against Sino Australia Oil and Gas Limited and its former chairman Tianpeng Shao*