REPORT 667

Response to submissions on CP 328 Initial public offers: Relief for voluntary escrow arrangements and pre-prospectus communications

August 2020

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 328 *Initial public offers: Relief for voluntary escrow arrangements and pre-prospectus communications* (CP 328) and details our responses to those issues.

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.

This report does not contain ASIC policy. Please see:

- Regulatory Guide 5 *Relevant interests and substantial holding notices* (RG 5); and
- Regulatory Guide 254 *Offering securities under a disclosure document* (RG 254).

Contents

A Overview

1 In Consultation Paper 328 *Initial public offers: Relief for voluntary escrow arrangements and pre-prospectus communications* (CP 328), we consulted on proposals to grant relief to facilitate:

(a) voluntary escrow arrangements requested by public companies, professional underwriters and lead managers in connection with an initial public offer (IPO); and

(b) company communications to employees and security holders about an IPO, before the company lodges a disclosure document.

2 This report highlights the key issues that arose out of the submissions received on CP 328 and our responses to those issues.

3 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 328. We have limited this report to the key issues.

4 We received four non-confidential responses to CP 328 from industry associations and a financial services provider. We are grateful to respondents for taking the time to send us their comments. Most respondents were supportive of our proposals to grant relief to facilitate, in relation to an IPO, voluntary escrow arrangements and pre-prospectus communications.

5 For a list of the non-confidential respondents to CP 328, see the appendix. Copies of these submissions are currently on the CP 328 page on the ASIC website.

Responses to consultation

6 The main issues raised by respondents related to:

(a) the scope of our proposed voluntary escrow relief, including proposals on categories of persons relieved, a cap on total escrowed securities and permitted transfer arrangements (see Section B); and

(b) the scope of our proposed relief for factual communications to employees and security holders about an IPO before a disclosure document is lodged, including proposals on categories of relieved persons and the form and content of the permitted communications (see Section C).

B Relief for voluntary escrow arrangements

Key points

This section outlines the feedback we received on the key aspects of our proposal in CP 328 to grant legislative relief for voluntary escrow arrangements, including feedback on:

- providing relief to public companies, professional underwriters and lead managers; and
- the proposed conditions and circumstances of relief.

Providing relief to public companies, professional underwriters and lead managers

7 In CP 328, we proposed to grant voluntary escrow relief to companies, lead managers and underwriters. The relief operates so that, for the purposes of Ch 6 takeover provisions, relieved parties do not have a relevant interest in securities merely because they require certain security holders to enter into voluntary escrow arrangements in connection with an IPO.

8 There was general support for the proposed escrow relief applying to public companies, lead managers and underwriters. However, a few respondents suggested that the scope of our proposed relief be extended as follows:

(a) one respondent suggested that our relief should accommodate unique structures and deed arrangements used by private equity firms; and

(b) another respondent suggested that our relief should operate such that joint underwriters or joint lead managers who enter into escrow arrangements are not deemed to be associates for the purposes of the takeover provisions.

ASIC's response

After consideration, we have decided to maintain the scope of our legislative relief to public companies, professional underwriters and lead managers for voluntary escrow arrangements in connection with a company's IPO.

It is appropriate to consider structures used by private equity firms on a case-by-case basis because applications involving situations such as those raised by some respondents to CP 328 are rare and relief may have broad implications.

We generally agree that where joint underwriters or lead managers enter into escrow arrangements they should not be deemed by that fact alone to be associates for the purposes of

the takeover provisions. However, there may be circumstances where joint underwriters or lead managers may be associates having regard to the escrow and other arrangements so it is appropriate to consider these situations on a case-by-case basis.

Circumstances and conditions of relief

9 We outlined the proposed conditions and requirements of voluntary escrow relief in CP 328. After reviewing submissions, we consider the final settings strike an appropriate balance between recognising the benefits of voluntary escrow relief and mitigating the potential for voluntary escrow arrangements to be used defensively against takeovers.

Limiting the percentage of escrowed securities

10 We sought feedback in CP 328 on our proposal to limit the total percentage of escrowed securities that a listed company can have on issue at the time of its admission to the official list of a prescribed financial market to:

(a) less than 50% of all securities in the listed company; or

(b) a range between 50% and less than 75% of all securities in the listed company.

11 Two respondents expressed concerns that our proposal to impose a cap on the percentage of securities that may be subject to escrow could have unintended consequences on IPO transactions, noting that:

(a) the proposed cap would effectively impose a higher free-float requirement than the 20% threshold imposed by the ASX under the Listing Rules, which may distort the IPO market; and

(b) there may be unintended complications around the application of the proposed cap—for example, in relation to timing and the treatment of convertible securities.

ASIC's response

We will not apply a limit on the percentage of escrowed securities permitted under the escrow relief as we are satisfied that it is sufficient for a company to comply with the minimum free-float requirements prescribed by the relevant financial market on which it is listing.

To minimise the potential defensive effect of escrow, we will continue to require that escrow arrangements subject to the relief allow the holder to accept into a successful takeover bid, vote and transfer securities in the context of a scheme of arrangement.

Transfers where there is no change in beneficial ownership

12 In CP 328, we proposed to allow escrowed securities to be transferred when:

(a) the transfer does not involve any change in the beneficial ownership of the escrowed securities;

(b) the transfer does not extend the duration of the original voluntary escrow arrangements; and

(c) the transferee agrees to or does inherit the same restrictions on voting and disposal under the original voluntary escrow arrangements.

13 We explained that this would mean that our escrow relief would continue to apply despite transfers of legal title:

(a) by the beneficial owner to a trustee or nominee who will hold the escrowed securities solely on behalf of the existing beneficial holder; or

(b) to a new trustee or nominee who will hold the securities solely on behalf of the existing beneficial owner; or

(c) to the beneficial owner who will obtain legal title to the securities and maintain its existing beneficial interest.

14 We also sought feedback on whether ASIC should consider permitting the voluntary escrow relief to continue in any other situation where the original restricted security holder no longer owns or holds the beneficial interest in the securities.

15 One respondent suggested that we expand the concept of 'permitted transfers' so that the relief continues following a transfer in the beneficial ownership of the escrowed securities in order to accommodate circumstances specific to transfers involving private equity investment vehicles.

16 Another respondent requested that we allow our relief to continue in other scenarios, such as those commonly contemplated and permitted in escrow agreements, such as:

(a) transfers to affiliates or affiliate funds, where 'affiliate' means 'any other person which directly or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, the holder or controller and, for the purposes of this definition, a general partner is deemed to control a limited partnership of which it is the general partner and, a company, trust, general or limited partnership or fund advised or managed directly or indirectly by a person or any of their affiliates will also be deemed to be controlled by such person';

(b) granting an encumbrance over the escrowed securities in favour of a bona fide third-party financial institution, provided that those securities may not be transferred to that financier for the duration of the escrow;

(c) transfer of the escrowed securities on the death or incapacity of the original restricted security holder; and

(d) any other dealing as required by any applicable law.

ASIC's response

After consideration, we decided to permit a transfer of beneficial ownership where a secured party becomes entitled to be recognised as the beneficial and legal owner of the escrowed securities and has taken its security subject to the escrow terms.

We acknowledge there may be other circumstances where it is appropriate to allow transfer of the escrowed securities, such as those between affiliated entities.

On balance, we consider that it is more appropriate that we assess these other scenarios on a case-by-case basis to enable us to assess whether allowing the subsequent escrow undermines the policy rationale of our escrow relief, given that in some cases the transfer may indicate that there is no additional need for, or benefit in, permitting the voluntary escrow arrangement to continue.

Where a transfer is subject to court orders (including in the case of death of a security holder) the parties may apply to ASIC for individual relief if the transfer and continued escrow otherwise results in the listed company contravening the takeovers threshold.

Type of escrowed securities

17 We proposed to grant relief to facilitate voluntary escrow over securities issued:

(a) under or in connection with an IPO; or

(b) before the IPO to a promoter, seed capitalist, vendor or service provider.

18 Two respondents supported our proposal to extend relief to previously issued shares as well as to new shares. However, they suggested that the proposed relief should not be tied to securities issued to particular persons (such as a promoter or vendor).

ASIC's response

Our relief will apply to escrowed securities:

- issued under or in connection with the IPO; or
- issued before the IPO where the escrow is entered into in connection with the IPO.

We consider that providing relief for securities issued before the IPO to any person does not detract from the rationale for permitting voluntary escrow arrangements in connection with an IPO. That is, the voluntary escrow still aligns the interests of the holders that are subject to escrow with those of other holders. It also promotes an orderly market for the securities by preventing an immediate sell-down by existing shareholders once the securities are quoted on an exchange.

To mitigate the risks of potential misuse of our legislative relief, it cannot be used to extend a prior escrow arrangement, such as a previous listing rule escrow, and our relief will cease no later than 12–24 months after the parties enter into the escrow arrangement.

Permitted terms of escrow arrangements

19 We proposed to retain the conditions and requirements for voluntary escrow relief set out in Table 11 of RG 5, including that the escrow agreement:

(a) restricts disposal and not voting;

(b) must allow the holder to accept into a successful takeover bid and allow the securities to be transferred or cancelled as part of a merger by scheme of arrangement;

(c) terminate no later than:

(i) one year after the date that the parties enter into the voluntary escrow for an escrow arrangement with an underwriter or lead manager; or

(ii) two years after the date that the parties enter into the voluntary escrow for an escrow arrangement with the company.

20 No respondents objected to the proposed conditions and requirements.

ASIC's response

Our relief will only apply where the escrow agreement meets the existing policy on voting, takeover offers, scheme of arrangement and duration.

C Relief for communications about an IPO before lodging a disclosure document

Key points

This section outlines the feedback we received on our proposal in CP 328 to grant legislative relief for communications about IPOs made by companies before lodging a disclosure document, including feedback on:

- the permitted recipients of the communications;
- the form and content of the communications; and
- the duration of relief.

Permitted recipients of the communications

21 In CP 328, we outlined our proposal to grant relief to allow companies to communicate factual information about a planned IPO to security holders and employees before the company lodges a disclosure document.

22 We sought feedback in relation to whether factual communications should be permitted to other persons under the proposed relief.

23 Respondents were generally supportive of our proposals for relief. However, some respondents suggested that ASIC should consider extending the scope of relief.

24 One respondent submitted that the relief should apply to pre-prospectus communications to all persons engaged by the company to do work in connection with an IPO, such as underwriters and lead managers, company advisers and other experts (e.g. in carrying out due diligence of other activities related to the IPO).

25 A second respondent submitted that the relief should be extended to private equity sponsors communicating with their equity holders. A third respondent, who is an intermediary that provides crowd-sourced funding (CSF) services, suggested that we consider relief for communications related to offers under the CSF regime.

ASIC's response

After considering precedent relief decisions and the parameters of our existing policy for relief, relief will apply for factual communications about an IPO to security holders and employees before the company lodges a disclosure document.

Consistent with our past approach, we have not expanded our relief to include due diligence work conducted in connection with an IPO. This is because we do not consider communications to persons involved in preparatory work for an IPO to be prohibited under s734(2) of the Corporations Act. We have updated RG 254 confirming our view.

We acknowledge that it may be appropriate to provide relief for communications to other parties. However, we consider it is preferable to do so through the provision of individual relief to ensure that the underlying principles of the pre-prospectus advertising provisions are met in these cases, and that the communications are not being made with an improper purpose.

Due to the differences in the regulatory regime for CSF offers, and the absence of applicable precedents, we do not propose to extend our legislative relief to CSF offers at this time.

Form of communications and requirement to update

26 We also consulted on whether a company that relies on the relief should be required to:

(a) make the exempted communications in writing; and

(b) update recipients of the exempted communications if the information previously provided is no longer accurate or up to date.

27 Two respondents suggested that:

(a) the relief should extend to communications not in writing; and

(b) there should be no requirement to update recipients of the exempted communications under the instrument.

ASIC's response

In response to the feedback received about the proposal to require the exempted communications to be in writing, we have decided not to impose this requirement. We agree it may unnecessarily restrict and complicate the form of communication and may increase, rather than reduce, red tape.

However, we consider that under our relief it is important for companies to update recipients of the exempted communications where necessary to ensure that information is accurate and up to date.

Permitted content of communications

28 We proposed to require companies relying on the relief to only communicate the specific information to employees and security holders, as set out in Table 1 of CP 328. So that the relief does not undermine the purposes of the legislation, which is to ensure investment decisions are made on a proper basis and not based on selective pre-prospectus information, we proposed that our relief would apply only where the company does not communicate the advantages, benefits or merits of the IPO in the communications.

29 One respondent submitted that our relief should also permit communications:

(a) to security holders about a 'FloatCo' or analogous structure;

(b) about a potential or expected price range for the sale securities with selling shareholders; and

(c) to former employees and security holders in relation to the treatment or restructures of existing remuneration or incentive arrangements or securities, including options.

30 Another respondent submitted that the relief should extend to cover situations where there are corporate restructures, particularly to allow communications to security holders from whom approval must be obtained in connection with an IPO.

ASIC's response

In response to the feedback on broadening the permitted content that may be communicated to security holders and employees, we have decided to extend our relief to cover communications:

- about the potential or expected price range for the sale securities with selling security holders; and
- to former employees and security holders in relation to the treatment or restructures of existing remuneration or incentive arrangements or securities, including options.

Considering the individual relief that we have historically provided to permit communications to security holders about a FloatCo or analogous structure, we are of the view that we can continue to appropriately facilitate these communications by providing individual relief. Given the complexity of the arrangements behind these structures, we consider this is a preferable approach to ensure that the underlying principles of the advertising provisions, and our relief, are met.

We do not consider it necessary to expand our relief to include communications to security holders for approvals in relation to corporate restructures in connection with an IPO in the relief. In most cases, these communications would already be permitted or required in a notice of meeting or other formal document to shareholders before obtaining approval for the restructure.

Duration of legislative relief

31 We sought feedback on whether we should limit the duration of the relief to a period ending on the earlier of:

(a) six months from the date of the first exempted communication;

(b) the date that the company lodges the disclosure document with ASIC.

32 Two respondents submitted that the relief should apply indefinitely.

ASIC's response

Given that companies will be required to ensure that pre-prospectus communications are accurate, current and factual in nature, our relief will apply indefinitely. This approach has the benefit of avoiding the need for a company to apply for individual relief in the event that the IPO is delayed, given that our policy for pre-prospectus relief is likely to be met, despite any delay.

Appendix: List of non-confidential respondents

- Australian Financial Markets Association
- Australian Investment Council
- Law Council of Australia
- On-Market Bookbuilds Pty Ltd