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ASIC Consultation Paper 328 – Initial public offers: Relief for voluntary escrow arrangements and pre-prospectus communications

Dear Ms Hussein,

As the voice of private capital in Australia, the Australian Investment Council is pleased to present its submission to the Australian Securities and Investment Commission **(ASIC)** on Consultation Paper 328, *Initial public offers: Relief for voluntary escrow arrangements and pre-prospectus communications* **(CP328**).

Private capital investment has played a central role in the growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include: private equity **(PE),** venture capital **(VC)** and private credit **(PC)** funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers. Our members include both Australian domestic and offshore-based firms.

Private capital fund managers invest billions of dollars into Australian companies every year. Australian-based PE and VC funds under management reached $33 billion in 2019, which represents a growth in available capital to support investment into businesses across every industry sector of the economy. The industry now has a combined total of around $13 billion in equity capital available to be invested in the short-term.

Given the recent impact of COVID-19 and the uncertain times that lay ahead, each and every day businesses are adjusting to the 'new world' economy and are finding ways to provide security to their employees, to increase productivity and to grow their businesses. In this context, it is timely that ASIC is looking to reduce red tape and assist businesses with the changes proposed in CP328.

The Australian Investment Council is supportive of policy initiatives and reforms that help to ensure our economy is competitive, stable, innovative and able to support Australia now and into the future. In particular, we encourage reforms and policies that help to maintain a stable framework for investment that will drive productivity, employment and restore economic growth.

We look forward to participating in any future discussion about the themes set out in this submission as part of ASICs work on streamlining the Initial Public Offer process. If you have any questions about specific points made in our submission, please do not hesitate to contact me or Brendon Harper, the Australian Investment Council's Head of Policy and Research, on 02 8243 7000.

Yours sincerely

Yasser El-Ansary
Chief Executive

Introduction

Within a matter of weeks, the advent of COVID-19 shifted Australia's economic outlook from growth to survival. It has significantly impacted the modus operandi of Australian businesses which has led to changing work and employment conditions as many businesses have closed or reverted to remote operations, events and conferences have been cancelled, and international and domestic travel almost brought to a complete halt.

Growing concerns about the impact of COVID-19 on the global economy has seen a drop in oil prices, interest rates cut by central banks around the world and market turmoil and volatility not experienced since, or arguably even during, the global financial crisis.

After a relatively lacklustre year in 2019, the Initial Public Offer **(IPO)** market on a global scale was ready for a resurgence in 2020. However, this sentiment has changed with the advent of COVID-19 with IPO candidates now facing a period of uncertainty ahead.

The private capital industry has for many years been an advocate for a strong and dynamic investment regime that supports businesses which will boost employment, productivity and economic growth. With the Australian economy facing significant growth challenges in the period ahead, it is imperative that the decisions made today support our economy in the short to medium term as the world continues to adjust to the shocks arising from COVID-19.

Consultation Paper 328 (CP328)

We commend the granting of relief that is proposed to the extent that it will reduce unnecessary legal and advice costs and ASIC filing fees for IPO candidates, and will enable ASIC staff to focus on other activities. However, in the current environment, we are concerned that some of the arrangements proposed in CP328 may have the unintended consequence of stifling, rather than buoying, the IPO market.

Main Concerns for the Private Capital Industry

While the Australian Investment Council is supportive of the intent of CP328, we have a number of concerns regarding the detail and practical implementation of the proposals. These include that:

- certain types of deeds would not be permissible;
- early partial release would not be facilitated; and
- the 50/75% cap would, in practice, be more restrictive than the ASX's 20% free float requirements.

We have provided more detailed comments below to the specific proposals in CP328 that are most pertinent to the private capital industry.

ASIC Proposal B1

Aligning our policy on listing rule and voluntary escrow arrangements

We propose to use ASIC's modification powers in Chapters 6 and 6C to grant conditional relief from the takeovers provisions of the Corporations Act: see s655A(1)(b) and 673(1)(b). Under this relief, certain entities (see proposal B2) would not have a relevant interest in securities merely because they required certain security holders to enter into voluntary escrow arrangements

ASIC Proposal B2

Providing relief to public companies, professional underwriters and lead managers

We propose to provide the voluntary escrow relief to: (a) public companies undertaking an IPO; (b) professional underwriters; and (c) lead managers.

Australian Investment Council Response

PE firms regularly obtain relief for companies that enter into escrow with sponsors which effectively provides the firms with an interest through securities. Currently this is done through escrow arrangements on terms agreed with the lead manager or the company undertaking the IPO (in consultation with key stakeholders).

Because of the nature of our industry, almost without exception, a PE firm will retain an interest in a company after the IPO until certain market forecasts are met. The voluntary escrow arrangement will be entered into by the company going to IPO.

Multiple parties with a relevant interest
There are circumstances where there may be a number of sponsors in a proposed IPO. As an example, the proposed float of Latitude Financial in 2019 had three owners – Kohlberg Kravis Roberts, Deutsche Bank and Värde Partners – each with a relevant interest in the business. If Latitude Financial proceeded to list on the Australian Securities Exchange, it would be critical for the three parties to sell their interest in a coordinated way at escrow release to avoid any market disadvantages or distortions that could occur if one of the parties sold ahead of the others. Coordination of the sell-down facility can be done in agreement with the lead manager.

Recommendation 1
Include PE structures in relief provisions for voluntary escrow arrangements
The Australian Investment Council recommends that options are included in relief provisions for voluntary escrow arrangements to accommodate unique structures and deed arrangements, while delivering a level playing field with other significant investors in an IPO.

ASIC Proposal B3
Limiting the maximum percentage of escrowed securities
B3 We propose to impose a limit on the total percentage of escrowed securities that a listed company can have on issue at the time of admission to a prescribed financial market, as a condition of our relief. This limit would either be: (a) up to 50% of all securities in the listed company; or (b) up to 75% of all securities in the listed company. The limit would include securities subject to listing rule escrow arrangements.

Australian Investment Council Response
In Australia, PE owners retain a relevant interest in the company after an IPO with some limited exceptions. This is a well-accepted business practice.

The consequence of capping the number of escrowed securities a company can have on an issue at 50% or 75% would effectively impose a free float requirement of more than 20%. In our view, this would be incongruous with the conditions required by ASX Listing Rule 1.1 Condition 7.

This proposal could have the unintended consequence of preventing the execution of some IPO transactions as it cannot always be guaranteed that an offer size representing more than 20% of shares on issue can be achieved. If the proposed limit is inconsistent with the ASX free float requirement, it would be possible that less than all of the shares of founders, sponsors or other major shareholders are subjected to voluntary escrow.

As a result, and particularly in the current economic climate, this may not be conducive to supporting future IPO transaction activity in Australia. This is because escrow is important for aligning the interests of new investors and existing shareholders, and in building confidence for participation in IPO transactions.

Early forecast release an exception
An exception under the proposals is the early forecast release where a proportion of the escrowed shares (usually 50%) is released if the IPO has performed according to, or above forecasts.

It would be inappropriate for different entities to be subject to different free float thresholds merely because one entity must rely on ASIC's relief, while others does not. Subjecting different free float thresholds to entities that rely on ASIC's relief provisions and those that do not could lead to unintended complications. For example, if the threshold is tested "at the time of admission" this could be at a time before the completion of the IPO in some circumstances. As a result, the escrowed securities could exceed 75% before the new shares are issued where settlement occurs on a deferred and conditional trading basis.

The UK Example
Sophisticated equity capital markets outside Australia have developed lock-up and tag mechanisms to address this issue. For example, in United Kingdom numerous deals have had these arrangements where the tag provides the opportunity for all significant escrowed parties to sell the same proportion of escrowed securities with the first-mover at the time of escrow release.

However, implementing these mechanisms in the Australian regulatory environment could result in the escrowed holders having both a relevant interest in each other's shares and an association from the time of IPO right through to the date of final escrow sell-down. Examples of lock-up practises in the UK, USA, Singapore and Hong Kong are included in **Appendix 1.**

Recommendation 2
No escrow limit at IPO completion
The Australian Investment Council recommends that no limit is placed on the number of escrowed securities an entity can have at the time of completion of an IPO due to circumstances where the timing for completion of an IPO may impact the number of escrowed securities that are held.

ASIC Proposal B4
Transfers where there is no change in beneficial ownership
B4 We propose 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 inherit the same restrictions on voting and disposal under the original voluntary escrow arrangements.
B4Q1 Should the voluntary escrow relief allow for transfer of some or all of the escrowed securities in the circumstances described in proposal B4?
B4Q2 Should we 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?

Australian Investment Council Response
It is our view that relief should allow transfer of all of the escrowed securities in the circumstances prescribed in proposal B4. However, there are additional circumstances that would involve a change in the beneficial ownership of the escrowed securities which need to be taken into account as they are considered to be standard, permitted transfers.

One of the benefits of having transferability facilitated through escrows is that it provides the capability to transfer ownership intrafund. This is applicable to PE funds which commonly use the 'affiliate concept' in their holding structures and these types of arrangements are likely to remain a typical exception in escrow deeds which don't require relief.

Previously, ASIC has granted relief to transfers to an affiliate that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the holder or controller of the entity. An example for PE is where a general partner is deemed to control a limited partnership of which it is a general partner and where a company, trust, general or limited partnership or fund advised or managed directly or indirectly by a person or any other affiliates will also be deemed to be controlled by that person.

This situation would also apply where a controller of the holder (if any) transfers its controller interests to its affiliates and/or affiliated fund.

Sharing of affiliates, unaligned beneficiaries
Private equity managers have a number of investors in each of their portfolio companies. These investors may change as the investment progresses. While the investment proportion by the PE fund will be the same, and under the same manager, the proposals do not allow for this practice.

Further, even though some PE funds are structured differently, and investment may shift from one part of the fund to another, the beneficial shareholder remains the same regardless of the structure.

The proposals do not accommodate these arrangements for PE and place restrictions on the types of deeds that would be possible.

Recommendation 3

Expand the conditions to accommodate private equity structures

The Australian Investment Council recommends expanding the conditions to encapsulate the circumstances specific to PE investment where there are limited partnerships, general partners, and trust structures.

ASIC Proposal B5

Transfers where there is no change of beneficial ownership

We propose that, to meet the requirement in proposal B4, the transfer (of legal title) must be: (a) by the beneficial owner to a trustee or nominee who will hold the escrowed securities solely on behalf of the existing beneficial holder; (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.

B5Q1 Do you agree with our list of circumstances in which transfer will meet the conditions of our relief?

Australian Investment Council Response

Like proposal B4, the list of circumstances outlined in proposal B5 are quite narrow and should be expanded to capture circumstances that apply to PE and VC investment in IPOs. Under the current draft, the proposed structure would restrict flexibility in allowing the transfer of securities to affiliates.

Recommendation 4

Expand the proposal to accommodate private capital entities

The Australian Investment Council recommends the circumstances outlined in proposal B5 are expanded to include structures particular to PE and VC funds, such as deed arrangements and trusts.

ASIC Proposal B6

Type of escrowed securities

We propose to grant conditional relief to facilitate voluntary escrow over securities issued: (a) under or in connection with the IPO; or (b) before the IPO to a promoter, seed capitalist, vendor or service provider.

B6Q1 Should the relief only apply to the circumstances in proposal B6? If not, please outline any other circumstances the legislative relief ought to apply to and provide reasons for your submission.

Australian Investment Council Response

We support the proposal to extend relief to previously issued shares as well as to new shares. PE firms invest in companies over the long term to ensure growth and returns for investors. In this respect, it is important that the measures outlined in Proposal B6 allow sufficient flexibility for the PE investor that pledged the share to be able to use the share as security for further investment after the company float. Relief should apply to the circumstances in proposal B6, and where there are existing securities, relief should not be restricted to the issue of securities to certain categories of people or entities.

Recommendation 5

Expand the relief definitions

The Australian Investment Council recommends relief be applied to the conditions outlined in Proposal B6 and that these are expanded to take into consideration the specific circumstances for PE and VC structures which use vehicles such as trusts and deed arrangements. We also recommend that the definition of relief allows for no restrictions to be applied the issue of securities to certain categories of people or entities.

ASIC Proposal C1

Allowing companies to communicate with employees and security holders about an IPO

We propose to use ASIC's modification powers (in s741(1)(a) of the Corporations Act) 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. C1Q1 Do you agree with proposal C1? If not, please explain why. C1Q2 Should factual communications to any other persons be permitted under the proposed relief? If so, please explain why.

Australian Investment Council Response

PE funds have an obligation to communicate with other shareholders in a pre-IPO scenario, on an equal basis with their equity holders. To meet this obligation, it is important that factual communications in relation to the IPO are permitted under the proposal relief to all persons engaged by the company to work on the IPO as well as security holders and for private equity firms, their equity holders.

Recommendation 6

Allow PE sponsors relief to communicate with their equity holders

The Australian Investment Council recommends that PE funds are permitted to communicate factual information about a planned IPO with their equity holders as part of ASIC's proposed relief conditions.

ASIC Proposal C2

Allowing companies to communicate with employees and security holders about an IPO

We propose to require a company that relies on our relief 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. C2Q1 Do you agree with the proposed requirements of relief, set out in proposal C2? C2Q2 Do you support any additional conditions to mitigate the risks of misinformation and drip-feeding of information about an IPO? If so, please include details of any measures you support to achieve this objective.

Australian Investment Council Response

As a general observation, the proposals in C2 may have the unintended consequence of introducing more red tape rather than less. We do not consider that there are any real benefits from a policy or business perspective by requiring a company that relies on relief to make the exempted communications in writing. Further, under existing IPO conditions, the entity has an obligation to provide updates if the information previously provided was no longer accurate so the proposal to update recipients of the exempted communications would appear to be superfluous.

Recommendation 7

No change to the current conditions

The Australian Investment Council recommends that ASIC's current relief conditions of "statements communicated" remain unchanged.

ASIC Proposal C3

Permitted content of communications

We propose to require companies relying on the relief to only communicate the permitted content in Table 1 to employees and security holders. The relief is conditional on the company not providing any communication of the advantages, benefits or merits of the IPO.

Australian Investment Council Response

We agree in-principle with ASIC's proposed permitted content for security holders and employees during an IPO as it is important that they are well informed through clear communication on the facts of the IPO to enable them to make informed decisions about their employment or the sale of securities through the IPO process. However, there are circumstances in an IPO where permitted content will be required to extend beyond employees or securities holders. For example, where there are corporate restructures in connection with the IPO, approvals that

are required under any existing shareholder agreements in connection with the IPO or any required corporate actions where communication of certain facts will be essential for the decision-making process.

Recommendation 8

Consider situations beyond employees and shareholders for the permitted content of communications

The Australian Investment Council recommends ASIC considers allowing permitted content to extend beyond employees and security holders to cover situations where there are corporate restructures in connection with an IPO as well as existing shareholder agreements which have been made in connection with the IPO or where there are required corporate actions.

ASIC Proposal C4

Duration of the legislative relief

We are seeking feedback on whether we should: (a) limit the relief so it ends on the earlier of: (i) six months from the date of the first exempted communication; or (ii) the date that the company lodges the disclosure document with ASIC; or (b) allow the relief to continue indefinitely to each exempted communication. Should the relief allowing a company to make exempted communications apply for a specific amount of time? C4Q2 If your answer to question C4Q1 is: (a) yes, do you consider relief for a period of up to six months from the first exempted communication appropriate? If not, what is the appropriate time period and why? (b) no, should the relief apply indefinitely? C4Q3 Is it preferable that the relief apply to each exempted communication, and therefore no end date apply? C4Q4 Please outline any unintended consequences you have identified may arise as a result of ASIC: (a) limiting the duration of the relief; (b) allowing the relief to apply indefinitely; or (c) drafting the relief to apply to each specific communication about an offer, such that a specific relief end date is unnecessary. C4Q5 Please provide details of appropriate strategies to deal with any consequences identified in question C4Q

Australian Investment Council Response

In practice, an IPO may be paused for reasons such as changed market conditions, which may extend the time period beyond six months. For this reason, applying a time limit of six months for the legislative relief would be impractical considering companies would lose the benefit of the relief if the IPO delay was extended. Further, there seems to be no significant policy reason why the relief should be subject to a time period when it applies to factual information on the IPO.

Recommendation 9

Limiting relief to a six-month time period would not be practical

The Australian Investment Council recommends that no end date is applied to the legislative relief for permitted content.

Appendix 1

Lock-up practises in other jurisdictions

For comparison, examples of how securities exchanges in other jurisdictions treat escrow arrangements and view private capital shareholders are outlined below.

How private capital investors are managed

Hong Kong

There are no differences in how private capital investors are managed where major shareholders are PE or VC sellers. Additionally, apart from the regulatory lock-up requirements set out in the Listing Rules, sometimes the issuer/sponsors /underwriters may require non-controlling shareholders (holding less than 30% of the voting power) to give voluntary lock-up undertakings.

UK

The lock-up period is typically fixed at 180 days for PE and VC. It may be longer if it applies to the founder.

USA
Differences in the drafting of the lock-ups are minimal for narrow carve-outs and non-market transfers. The dynamics between banks and sponsors in those deals mean early releases are likely if the listing performs well.

Singapore
If a PE/VC seller invested in the issuer less than 12 months prior to the date of the listing application (and not the listing date), a portion of their holdings in respect of those acquired within the one-month period will be subject to a six-month moratorium from the listing date. Generally, the higher discount at which the seller acquires the shares, will mean a higher proportion of its holdings will be subject to moratorium arrangements. Where such an investor's holdings account for 5% or more of the issuer's post-IPO share capital, the investor could only sell shares which are not subject to the moratorium in the IPO. However, if the holdings account for less than 5% of the post-IPO share capital, no limitation applies on the number of shares it could sell in the IPO.

Listed Company involvement in early escrow release
Hong Kong
No

UK
No

USA
Yes. In practice, there can be no registered follow-on offering without the company's support. Typically, the company's sponsor will control whether and when to request a waiver. For syndicate portfolio companies, the sponsors' lock-ups may include provisions regarding cross-release, that is, if the lead manager releases Sponsor X it must also release Sponsor Y (or Founder Z) to the same extent.

Singapore
No. The issuer is not a party to the undertaking.

Lead Manager involvement in direct agreements with shareholders
Hong Kong
The controlling shareholder(s) usually gives a deed of undertaking (lock-up undertaking) to the listing applicant (the issuer), the Stock Exchange and the sponsors (the sponsors are the investment banks that assist the listing applicant with its initial application for listing). The listing rules impose an initial six-month lock-up on shareholders who hold 20% or more of shares at admission, plus a further six-month prohibition against disposing of shares which would result in those shareholders ceasing to hold 30% of shares. The listing rules also impose a six-month issue lock-up against the issuer. Also, it is the Hong Kong Securities Exchange practice to require cornerstone investors to be subject to a six-month lock-up post-admission.

UK
Either in an underwriting agreement if they are selling or a separate lock-up deed if they are not. Typically lock-up is for the benefit of all joint book-runners, although any right to waive is with joint global coordinators. There are no statutory or regulatory requirements for any post-listing issuer or shareholder lock ups.

USA
The lead managers will require each director, executive officer and 5% holder to execute a lock-up agreement directly with the lead managers. This is a commercial arrangement and not required by any securities law or regulation. However, Domestic US issuers (but not foreign private issuers) are subject to a rule whereby any profit realised by directors, officers or 10% beneficial holders from the purchase and sale of any registered equity security within a period of less than six months must be paid to the issuer.

Singapore
The practice in Singapore is for an undertaking to be provided by the major shareholders directly to all underwriters (and not just the lead managers).