



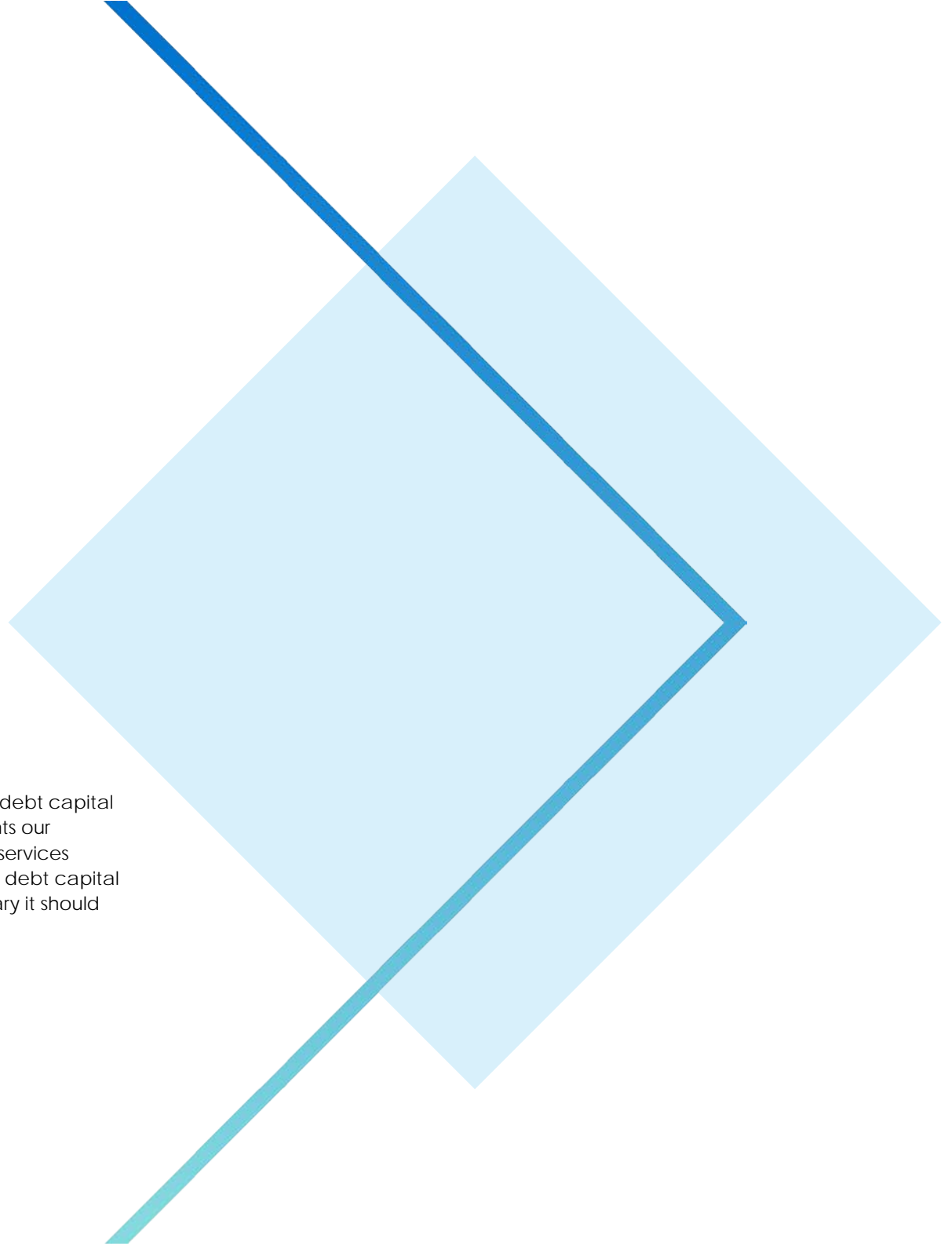
ASIC
Australian Securities &
Investments Commission

Allocations in debt capital market transactions

Report 668 | September 2020

About this report

This report summarises the findings of our thematic surveillance of debt capital raising practices and selected transactions (2018–2020). It highlights our observations and sets out better practices for Australian financial services licensees (licensees) acting as intermediaries operating in primary debt capital markets. Where an entity is both an issuer and licensed intermediary it should consider better practices in the context of the role(s) performed.



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About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents: consultation papers, regulatory guides, information sheets and reports.

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.

Executive summary

Following our thematic surveillance of allocations in debt capital raisings from 2018 to 2020 (inclusive), we identified what we consider to be poorer and better practices by licensees when managing bond issuance in the primary debt capital markets (including by public issuance and private placement).

Important role of debt capital markets

A properly functioning debt capital market (DCM) is vital for the real economy. Active and liquid DCMs also assist with the efficient pricing and allocation of debt capital.

Poor conduct in DCMs can reduce the confidence of issuers and investors, resulting in reduced participation and higher funding costs. Accordingly, the proper management of risks associated with allocation of debt securities—including managing conflicts of interest and ensuring information provided to issuers and investors is accurate and not misleading—is essential.

Overview of review methodology

We engaged with a range of industry participants including institutional investors, licensees, issuers, industry bodies and international regulators. We also reviewed 12 DCM transactions (see Appendix 1) both before and during the COVID-19 pandemic. The better practices in this report also align with the principles in the final report of the International Organization of Securities Commissions (IOSCO) [Conflicts of interest and associated conduct risks during the debt capital raising process](#) (PDF 431 KB) (September 2020), relating to allocations.

Our key findings

This report describes our work in reviewing the conduct of licensees in DCMs with a focus on Australian dollar-denominated debt issued by Australian-domiciled issuers (collectively 'DCM transactions').

We have observed some poorer and better practices, including:

- › **Conflicts of interest:** Some licensees have overly generic arrangements to manage conflicts of interest—licensees must have effective controls to identify and manage or avoid conflicts of interest for each DCM transaction.
- › **Inside information:** There were mixed approaches for identifying and managing inside information. It is important that licensees have clear policies, procedures and training for identifying and managing confidential and market-sensitive information that arises in the course of a DCM transaction.
- › **Bookbuild information:** We observed instances where inflated bids were not identified as such in bookbuild information. We also noted differing methods for disclosing the interests of the joint lead manager (JLM) to investors. In all stages of a DCM transaction, information provided to issuers and investors must be accurate, and not misleading or deceptive.
- › **Supervision and monitoring:** We observed instances of 'light touch' or reactive oversight. DCM transactions should be adequately and demonstrably supervised and monitored on a timely basis.
- › **Post-deal statistics:** Investors are seeking more meaningful post-transaction information on how securities were allocated. This would improve investor understanding and confidence in allocations.

Legislation

Some of the relevant provisions of the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001* (ASIC Act) are summarised below:

- › Licensees have a number of obligations under section 912A of the Corporations Act to:
 - do all things necessary to ensure that the financial services covered by their Australian financial services (AFS) licence are provided efficiently, honestly and fairly
 - have in place adequate arrangements for managing conflicts of interest (also see [Regulatory Guide 181](#) *Licensing: Managing conflicts of interest* (RG 181)), and
 - have adequate compliance arrangements.
- › Certain practices, such as 'laddering' (providing a preferred allocation in exchange for agreement to place orders in the after-market), may breach prohibitions against market manipulation: Part 7.10 of the Corporations Act.
- › Poor conduct around messaging the status of an offer during marketing or feedback to clients after the offer about the level of demand and extent of any scale-backs may breach prohibitions in Part 7.10 of the Corporations Act and Part 2 of the ASIC Act relating to misleading and deceptive conduct.
- › Potential risk that transactions undertaken in conjunction with or ahead of a DCM transaction may breach prohibitions in Part 7.10 of the Corporations Act relating to insider trading.

Debt capital markets

Australia has an active wholesale market for raising debt capital, which plays a key role in providing funds for governments and businesses. We observed strong levels of investor demand for quality DCM issues.

DCM transactions

In Australia, DCM transactions are dominated by large issuers, licensed intermediaries (usually banks) and wholesale investors.

Issuers are often categorised as 'frequent issuers' such as the Commonwealth Government, state governments, banks and some large corporations, or 'infrequent issuers' covering all other entities. Characteristics of these categories include:

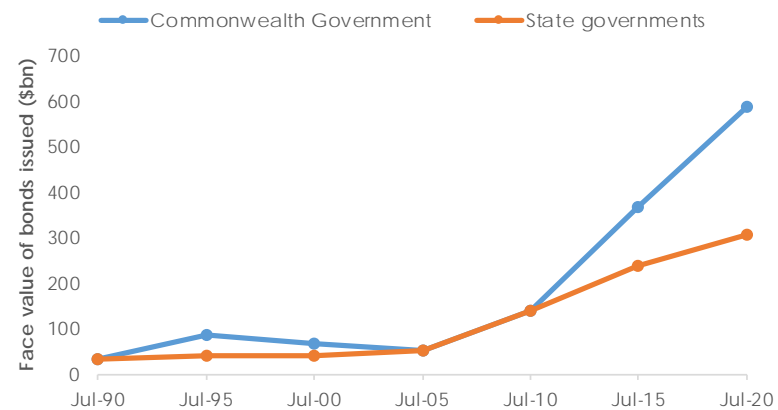
- › *Frequent issuers*—tend to have a strong understanding of their objectives from DCM transactions, have established preferences for categories of investors, and are actively involved in allocation decisions when engaging with licensees. Frequent issuers will often appoint intermediaries from a panel of licensees who are required to place new issues and make a secondary market in those securities.
- › *Infrequent issuers*—are more reliant on licensees to guide them through the various stages of a DCM transaction, including the allocation process. These issuers are less likely to have an established panel of licensed intermediaries to help with debt security issues.

Key investors in Commonwealth Government debt securities include:

- › sovereign wealth funds and central banks, and other public sector entities
- › institutional investors including bank treasury functions and trading desks, superannuation funds, life assurance and insurance providers
- › investment funds and hedge funds, and
- › corporations.

Source: [Australian Office of Financial Management](#).

Figure 1: Government bonds on issue in Australia



Sources: ABS, AOFM, RBA, State Treasury Corporations.

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

ASIC's market supervision focus

The conduct of licensees in relation to capital raisings continues to be a focus area for ASIC. A fair and efficient approach to the allocation of debt securities promotes market integrity, improves market efficiency and increases investor confidence.

Oversight of capital markets in Australia

We continue to focus on licensee conduct in relation to capital raising activities, building on our findings and better practices in [Report 605 Allocations in equity raising transactions](#) (REP 605).

Given there are some similarities between debt and equity raising, many of the better practices in REP 605 are equally relevant to DCM transactions. We observed that a number of licensees have already incorporated the better practices from REP 605 into their DCM activities.

Both types of capital raising involve marketing securities to investors (typically on behalf of an issuer), providing messaging to investors and making allocation decisions based on a range of discretionary criteria.

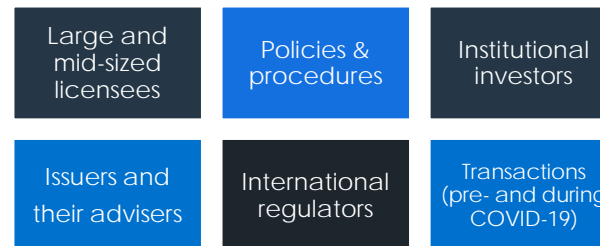
There are some differences between the process for raising debt as opposed to equity. Debt has a maturity profile and new issues are generally limited to institutional investors. Frequent debt issuers seek to develop a 'curve' with active secondary market trading in benchmark bond lines. Infrequent issuers may seek debt capital as an alternative to using bank credit facilities.

Our work on allocations in DCM transactions

Our review focused on the conduct of licensees in connection with DCM transactions. This included handling confidential information, managing conflicts of interest, messaging, engaging with issuers, how allocation recommendations are made, allocations to parties connected to the licensee and compliance and supervision arrangements.

We engaged with licensees, institutional investors, issuers, industry associations and international regulators.

Figure 2: Scope of our review



Note: Figure 2 is explained in the surrounding paragraphs (accessible version).

We reviewed the policies, procedures and practices of a range of Australian-based licensees who are active in DCM transactions. We also reviewed a selection of DCM transactions (see Appendix 1).

“Licensees should review their DCM practices and consider whether their controls, including policies, procedures and monitoring, are appropriate and sufficiently robust to meet legal and regulatory requirements.”

Cathie Armour | ASIC Commissioner

Licensee engagement with the issuer—Origination

Licensees need to ensure that the objectives of issuers are their primary focus in DCM transactions, while complying with licence obligations.

Focus of our work

We looked to see how licensees manage their regulatory obligations when issuers engage with them in relation to potential DCM transactions, including:

- › identifying and managing related conflicts of interest by controlling or avoiding and disclosing conflicts of interest
- › ensuring information provided to issuers is accurate and not misleading, and
- › handling confidential information and using appropriate information barriers.

Key observations

- › There is strong competition between licensees for DCM transactions, and proactive marketing to issuers is common.
- › Licensees use a mix of approaches for managing conduct risks that may arise from seeking and obtaining a mandate—these include identifying conflicts due to related roles and managing confidential information about upcoming issues.

- › While licensees generally have policies and procedures which cover allocation recommendations, the policies often do not adequately cover all aspects across the lifecycle of DCM transactions.

Better practice

We expect licensees to carry out applicable tasks, including:

- › having policies and procedures in place that cover the lifecycle of DCM transactions
- › documenting the issuer's expectations about the role of the licensee in managing the debt securities offering, including disclosing and managing conflicts of interest, communications and updates, and decision making
- › engaging with the issuer throughout the transaction, and
- › adequately demonstrating that the interests of issuers are the primary focus when conducting DCM transactions.

We encourage issuers to engage with licensees throughout the transaction, including understanding how conduct risks are managed and ensuring the allocations are consistent with their objectives.

Note: For further information on better practices refer to [REP 605](#), D1 and D2. Also see [RG 181](#), [Regulatory Guide 79](#) *Research report providers: Improving the quality of investment research* (RG 79), [Regulatory Guide 264](#) *Sell-side research* (RG 264) and [Report 393](#) *Handling of confidential information: Briefings and unannounced corporate transactions* (REP 393).

Market soundings, cornerstone investors and reverse inquiries

Pre-offer activities to gauge interest for a potential DCM transaction can give rise to conduct risks that need to be carefully managed.

Focus of our work

We looked at market practice for pre-offer investor engagement to understand how licensees are meeting their regulatory obligations, including managing inside information.

Key observations

- › Licensees are in regular contact with issuers and investors to discuss market conditions, investor demand and funding requirements. Investors, at times, also initiate contact with issuers, often via licensees ('reverse inquiry').
- › Licensees and investors have observed a reduction in the use of 'market soundings'—as investors are reluctant to be provided with non-public information about a proposed transaction and be wall-crossed. It is also less common for DCM transactions to be underwritten, except for lesser-known issuers or complex transactions.
- › Licensees typically have in place policies and processes for handling confidential information associated with some pre-offer

activities (e.g. market soundings). These include restricting inside information, using wall-crossings and non-disclosure agreements. We noted that some licensees do not actively monitor lists of potential transactions (i.e. 'deal pipelines') to check whether these processes should be commenced.

- › We also noted mixed practices for monitoring pre-offer activities, with compliance functions performing surveillance post-transaction rather than in real time. This can create issues as to whether the relevant policies and procedures are being followed at the time of greatest risk.

Better practice

At a minimum, we expect licensees to:

- › have robust policies and processes to actively identify upcoming DCM transactions, inside information and the range of financial products this may affect, and to ensure all relevant parties are wall-crossed
- › ensure that pre-offer communications are accurate and not misleading or deceptive, and
- › ensure that the licensee's compliance and supervision functions are actively monitoring pre-offer engagement activities.

Note: For further information on better practices, see [REP 393](#).

Allocation recommendations

Licensee allocation recommendations must be consistent with issuer objectives and preferences.

Focus of our work

We aimed to understand how licensees develop their allocation recommendations for issuers, including:

- › meeting the issuer's objectives when managing a transaction
- › managing conflicts of interest, and
- › ensuring that the financial services covered by the licensee are provided efficiently, honestly and fairly.

Key observations

- › Frequent issuers (in particular, government sector issuers) tend to be active in controlling the allocation criteria and individual allocations. For example, government sector issuers often have their own confidential allocation criteria that are not disclosed to the licensees managing the transaction. While these issuers finalise allocations, they may take advice from licensees. Infrequent issuers place greater reliance on the allocation recommendations of licensees.
- › Licensees typically have policies and procedures that set out a range of discretionary criteria for making allocation

recommendations. Many licensees revised their allocation policies to incorporate the better practices set out in REP 605 and often incorporated standards from relevant industry associations.

- › Licensees with better developed allocation policies generally reinforce that allocation recommendations must be in the best interests of the issuer. Generally, these policies take into account issuer preferences and cover criteria such as the nature of the investors (with a preference for long-term investors), interest in the transaction, geographic location, history with the issuer or similar issuers, price leadership and the price bid.

Better practice

We expect licensees to have policy and procedures setting out their process for managing allocation recommendations that:

- › require issuers' allocation objectives and preferences to be the primary consideration and maintain records of transactions, including allocation recommendations and decisions
- › avoid or manage potential conflicts of interest
- › consider a range of factors to ensure a fair and efficient allocation process, and
- › are discussed with issuers before the commencement of a mandate and are available to investors.

Note: See 'Allocations to parties connected to licensees' and 'Compliance and supervision arrangements' (below) for other pertinent practices. Also refer to [REP 605](#), C1 for relevant better practices that licensees should consider in making allocation recommendations for DCM transactions.

Messages to investors

Messaging during the offer phase can influence bidding behaviours. It is critical that licensees provide information that is timely, accurate and not misleading or deceptive.

Focus of our work

Poor conduct around messages to potential investors in DCM transactions can impair investor trust and confidence in the offering process and may result in breaches of Part 7.10 of the Corporations Act and Part 2 of the ASIC Act relating to misleading or deceptive conduct. Where ASIC has concerns with intermediary conduct in capital raising transactions, we will consider taking action.

Key observations

- › Messages to investors are typically provided at key stages of the DCM transaction including mandate announcement, deal launch and, during the bookbuild phase, 'updates' on book size and price guidance.
- › Messages typically include information about whether demand includes or excludes 'JLM interest', but not the quantum.
- › While allocation statistics are sometimes published by issuers, investors indicate that greater transparency and more meaningful information on allocations would increase investor confidence in the allocation process.

Example of bookbuild update message

- › Firm orderbook in excess of A\$500m (excl. JLM interest)
- › Price guidance revised to 4.345% +/- 5bps
- › Deal size min A\$400m
- › Timing: Expect book to close at 11.00 am Sydney

Better practice

At a minimum, we expect licensees to:

- › ensure that messages are appropriate in scope and timing and are accurate and not misleading or deceptive
- › take all reasonable steps to identify inflated bids, including using their knowledge of the bidder's capacity and previous transaction behaviours—and exclude these from the publicised book size, and
- › when publicising book size, either disclose the amount of JLM interest included in the current book size or disclose the book size excluding JLM interest and make this clear.

(Also see 'Allocations to parties connected to licensees' (below).)

We encourage issuers to:

- › provide sufficient and meaningful information on final allocations to investors, including any allocations to JLM interests.

Allocations to parties connected to licensees

Bids from parties connected to licensees managing a DCM transaction can help to meet issuer objectives. However, they can give rise to significant conflicts of interest, requiring effective management.

Focus of our work

We looked to understand how licensees manage conflicts of interest arising from bids by, and allocations to, parties connected to licensees, including related disclosures to issuers and investors.

Key observations

- › Bids by related entities of licensees that manage funds on behalf of third-party investors are typically treated consistently with non-related investment managers.
- › Bids by JLM banks for balance sheet investment are typically treated consistently with non-related balance sheet bids.
- › Bids by JLM trading desks are characterised as 'JLM interest'. JLM trading desk bids compete with bids by parties unconnected to the licensee. However, issuers often make allocations to JLM trading desks to increase secondary market liquidity in the bond.
- › For oversubscribed issues, investors queried allocations to parties connected to the licensees, particularly JLM interest.

Better practice

We expect licensees to have robust policies and procedures to ensure:

- › conflicts of interest are identified and managed effectively or avoided
- › the issuer and investors are notified that parties connected to the licensee are likely to bid, and may receive allocations
- › effective information barriers for bids by any parties connected to the licensee. These bids are to be treated consistently with similar types of investors, including the scope and timing of information provided to them
- › JLM trading bids are characterised as 'JLM interest'
- › recommendations of allocations to parties connected to the licensee are in the issuer's interests and not their own. The issuer is provided with a reason for such recommendations, and
- › for oversubscribed issues, ensure priority is given to the investor's interests where there is a conflict with 'JLM interest' and allocation recommendations to 'JLM interest' are appropriately scaled back or avoided where possible.

Note: Refer to [RG 181](#). Also see [REP 605](#), C1 for other better practices, as applicable.

Engagement with the issuer during bookbuild and allocations

Issuers rely on licensees to provide accurate and timely information during the bookbuild process.

Focus of our work

We aimed to understand market practices during a bookbuild.

Key observations

- › Licensees have active engagement with issuers during DCM transactions, including determination of price and volume.
- › JLMs are typically allocated specific roles (e.g. documentation, billing and delivery agent, risk manager).
- › Bids can be made on an outright (i.e. cash), exchange for physical or a switch (i.e. a different bond) basis. Bids are typically made at a level within the price guidance, or at reoffer.
- › Bids are typically recorded on a central electronic bookbuild system. Licensees typically provide issuers with access to a bookbuild system, often in real time.
- › We saw instances of inflated bidding for some issues, which may leave a misleading impression of offer demand.
- › We observed instances of 'masked' or 'X' bids (to mask the identity of an investor) that were not identified to the issuer.

- › Licensees provide allocation recommendations to issuers. Issuers are typically involved in determining final allocations.

Better practice

We expect licensees to:

- › before the transaction, agree the approach to the bookbuild with the issuer, having regard to the issuer's requirements and the licensee's policies and procedures
- › take all reasonable steps to identify inflated bids, including knowledge of the bidder's capacity and previous transaction behaviours—and to highlight any such bids in the bookbuild information provided to issuers
- › provide issuers with real-time transparency of the bookbuild information, including conditional interest and time of bids
- › inform issuers of actions which can influence the outcome of the transaction, and obtain and document issuers' preferences and decisions on the key terms of the issue and allocations
- › ensure that issuers are provided with the identity of all investors before making allocation decisions, and
- › ensure that information provided to the issuer is accurate and not misleading or deceptive.

Note: Also see [REP 605](#), D1 and D2 for better practices, as appropriate.

Compliance and supervision

We expect licensees facilitating DCM transactions to have robust compliance arrangements in place.

Focus of our work

We analysed the oversight arrangements licensees have in place for their role in DCM transactions.

Key observations

- › We found instances where management oversight of some key stages of DCM transactions was lacking. These included messaging provided to investors and allocation recommendations to issuers. We also found inadequate assessments of inside information and poor identification of conflicts of interest.
- › While licensees indicated that DCM transactions were subject to review by compliance, they were often limited to the screening of e-communications. Key communications by licensees, such as messaging sent to investors and allocation recommendations to issuers, were rarely reviewed by compliance.
- › Our review also indicated that while DCM businesses of licensees were covered by internal audit programs, reviews of the effectiveness of the licensee's policies (and related conduct risk monitoring) for DCM transactions were infrequent.

Better practice

We expect licensees facilitating DCM transactions to:

- › ensure that DCM transactions are always properly and demonstrably supervised
- › ensure they are complying with their regulatory obligations on an ongoing basis
- › clearly articulate and document the role of compliance in DCM transactions in all key stages, including the allocation process
- › identify, control or avoid and disclose conflicts of interest
- › regularly assess adherence to the issuer's allocation requirements and the licensee's allocation policy
- › effectively monitor conduct in DCM transactions for compliance with related policy and procedures
- › have meaningful consequences for individuals who breach a licensee's internal policy and procedures
- › consider the heightened risks of prolonged remote working arrangements—for example, handling of inside information and inappropriate use of personal communication or technology devices, and
- › ensure their internal audit function regularly assesses the effectiveness of DCM policies, the related control framework and oversight arrangements, including completion of in-depth reviews, where warranted.

Note: Refer to [REP 605](#), C2 for better practices on the role of compliance (or an equivalent review function) in the allocation process.

Areas of ongoing work

We will continue to monitor DCM transactions, including the following activities.

Risk management

Pricing (and related risk management transactions) in DCM transactions is an area where there is potential for conduct risks and where market abuse could occur.

We will continue to test selected transactions to determine trading activities that licensees are engaging in ahead of, or in conjunction with, DCM transactions.

Management of information, conflicts of interest and control rooms

Access to information about actual or upcoming DCM transactions can give rise to significant conduct risks such as insider trading,

market manipulation and failure of licensees to comply with their obligations—including adequately managing conflicts of interest.

Conflicts of interest must be comprehensively identified across the lifecycle of a DCM transaction. Once identified, they must be controlled, avoided or disclosed to the appropriate party.

We are currently undertaking a separate review of the arrangements that licensees have in place for managing conflicts of interest and confidential information in their wholesale markets businesses (including the role of control rooms) to ensure these are adequate.

Transaction reviews

We will continue to review DCM transactions to test market practice and see how the better practices in this report are being applied by licensees.

Similarly, we will continue to undertake periodic reviews of equity capital raising transactions to see how firms are following the better practices set out in REP 605.

Appendix 1: Transactions reviewed

Table 1: Transactions reviewed as part of our surveillance

Issuer	Issue date	Amount raised	Tenor (years)	Issue rating (S&P) at issue date	Maturity	Syndicate members reviewed (where applicable)
Commonwealth Government (Australian Office of Financial Management)	17/1/2018	A\$9.6bn	11	AAA	Nov 2029	(No syndicate member reviewed)
Sydney Airport Finance Company Pty Limited	26/4/2018	€500m	10	BBB+	2028	BNP Paribas SA
Civmec Holdings Pty Limited	30/11/2018	A\$60m	4	Unrated	2022	National Australia Bank Limited
South Australian Government Financing Authority	13/2/2019	A\$750m	11	AA+	2030	Merrill Lynch (Australia) Futures Limited
Virgin Australia Holdings Limited	5/3/2019	A\$250m	5	B	2024	Australia and New Zealand Banking Group Limited
Treasury Corporation Victoria	20/3/2019	A\$2.5bn	10	AAA	2029	(No syndicate member reviewed)
Insurance Australia Group Limited	28/3/2019	A\$450m	26	BBB	2045	Westpac Banking Corporation Limited
Woolworths Group Limited	23/4/2019	A\$400m	5	BBB	2024	Citigroup Global Markets Australia Pty Limited
SCT Logistics Twentieth Super Pace Nominees Pty Ltd As Trustee of The Bryns Smith Unit Trust	3/6/2019	A\$100m	5	Unrated	2024	FIG Securities Limited
GPT Wholesale Office Fund No. 1	12/7/2019	A\$200m	6.5	A-	2026	Commonwealth Bank of Australia
Commonwealth Government (Australian Office of Financial Management)	13/5/2020	A\$19bn	10	AAA	Dec 2030	Australia and New Zealand Banking Group Limited
Woolworths Group Limited	20/5/2020	A\$1bn	5, 10	BBB-	2025, 2030	Westpac Banking Corporation Limited

Appendix 2: Accessible version of Figure 1

This appendix is for people with visual or other impairments. It provides the underlying data for Figure 1.

Table 2: Government bonds issued in Australia

Issuer	Jul 1990 (\$bn)	Jul 1995 (\$bn)	Jul 2000 (\$bn)	Jul 2005 (\$bn)	Jul 2010 (\$bn)	Jul 2015 (\$bn)	Jul 2020 (\$bn)
Commonwealth Government	33	87	68	51	140	369	587
State governments	34	40	42	52	138	240	307

Sources: ABS, AOFM, RBA, State Treasury Corporations

Note: This is the data shown in Figure 1.

Key terms and related information

Key terms

Bookbuilding	Bookbuilding is the process of facilitating and recording investor demand for a security in a DCM transaction
JLM interest	Bids by trading desks of licensees involved in a DCM transaction (e.g. this may be as a sole or joint lead manager or syndicate member)
Syndicate members	Syndicate members will typically be appointed to one or more roles to facilitate a syndicated bond issue, which may include an arranger, lead manager, communications manager, due diligence arranger, ebook provider, billing and delivery agent, risk manager or underwriter

Related information

ASIC documents

[REP 393](#) *Handling of confidential information: Briefings and unannounced corporate transactions*

[REP 605](#) *Allocations in equity raising transactions*

[RG 79](#) *Research report providers: Improving the quality of investment research*

[RG 181](#) *Licensing: Managing conflicts of interest*

[RG 264](#) *Sell-side research*