



ASIC

Australian Securities &
Investments Commission

REPORT 605

Allocations in equity raising transactions

December 2018

About this report

This report sets out the findings from our review of market practice for the allocation of securities in equity raising transactions in the Australian market. It focuses on the conduct of licensees and the factors considered in making allocation recommendations to issuers.

The findings and better practices are relevant to Australian financial services (AFS) licensees and listed entities, or entities seeking to list on an exchange.

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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Executive summary

1 A fair and efficient approach to the allocation of securities to investors in capital raising transactions promotes market integrity, improves market efficiency and increases investor confidence.

2 Australian financial services (AFS) licensees are subject to a range of obligations in s912A of the *Corporations Act 2001* (Corporations Act), including the requirement to provide financial services efficiently, honestly and fairly, and to have in place adequate arrangements for the management of conflicts of interest.

Note: See [Regulatory Guide 181](#) *Licensing: Managing conflicts of interest* (RG 181).

3 This report sets out the findings from our review of market practice for the allocation of securities in equity raising transactions (transactions).

4 The report focuses on the conduct of licensees and the factors considered in making allocation recommendations, including how conflicts of interest are managed. The report includes observations relevant to issuers and investors.

Note: In this report, a reference to ‘issuers’ refers to listed entities, or entities seeking to list on an exchange, who are seeking to raise equity capital.

5 We reviewed the policies, procedures and practices of a range of Australian-based licensees and reviewed a selection of transactions. We also engaged with institutional investors, licensees, independent corporate advisers, issuers, industry associations and international regulators.

6 The report also sets out better practices that licensees can adopt to help them meet their regulatory obligations. It also identifies a number of better practices for issuers. Some of the findings and better practices may also have application to allocations in debt raising transactions.

7 We have previously set out initial findings on allocations and some better practices for allocations in transactions. We have also released guidance outlining our expectations of how licensees should manage conflicts during the capital raising process, including avoiding, controlling and disclosing conflicts.

Note: See [Report 486](#) *Sell-side research and corporate advisory: Confidential information and conflicts* (REP 486) and [Regulatory Guide 264](#) *Sell-side research* (RG 264).

Background

8 This report builds on previous work by ASIC on handling confidential information and managing conflicts in the provision of sell-side research.

9 In August 2016, we published REP 486, which focused primarily on our concerns about managing conflicts in the provision of sell-side research. During our review on sell-side research, we examined several transactions which identified some poor practices by licensees in relation to allocations. This report builds on this work.

Note: See REP 486, paragraphs 112–119.

10 We have taken action where we have seen poor conduct relating to allocations and messages provided to investors, including accepting court enforceable undertakings from:

- (a) Foster Stockbroking Pty Limited (FSB) in November 2017. We were concerned that by giving preferential treatment when allocating shares to its directors that FSB failed to adequately manage conflicts of interest. FSB has undertaken to implement a number of changes to its systems and controls and was required to appoint an independent expert to assess and evaluate the adequacy and implementation of its policies and undertakings. FSB also made a community benefit payment of \$80,000.
- (b) Goldman Sachs Australia Pty Ltd (GS Australia) in July 2018. We had concerns about certain representations made by GS Australia to potential investors about the minimum fixed demand in relation to a block trade transaction. This required GS Australia to conduct an internal review of policies, procedures, systems, controls, training, guidance and the monitoring and supervision of employees engaged in transactions lead managed by GS Australia. GS Australia also made a community benefit payment of \$500,000.

11 Any action we may take when we see poor conduct relating to allocations is not limited to negotiated actions of the type described above. Issuers and licensees should anticipate that ASIC will apply the full range of its regulatory tools, including formal enforcement action, depending on the circumstances of the conduct.

12 Overseas regulators have had concerns about allocation practices, which have led to a regulatory response in several international jurisdictions: see Appendix 1 for a summary of these responses, including recently released guidance from the International Organization of Securities Commissions (IOSCO) in relation to conflicts of interest during the allocation of equity securities.

Findings

- 13 We found that receiving an allocation can provide a benefit to investors in both initial and secondary capital raisings as, on average, the price of the securities issued in a transaction trade above their issue price shortly after the transaction. This may suggest that issuers do not always obtain the best absolute price for the transaction.
- Note: For the purpose of this report:
- initial capital raisings refer to transactions where securities of an issuer are first listed on an exchange (e.g. an IPO); and
 - secondary capital raisings refer to transactions where additional capital is raised by issuers listed on an exchange (e.g. placements, pro rata offers and security purchase plans).
- 14 Issuers make decisions to raise equity capital and engage licensees to undertake transactions. We found the level of engagement by issuers in the allocation process depends on their experience and if they have strong views about allocations to individual investors or groups of investors.
- 15 While an issuer’s primary objective from allocations is to raise the funds sought, it also provides an opportunity to consider the composition of its register and increase liquidity in its securities. In meeting the objectives of issuers, we found that licensees consider a range of discretionary criteria to help them make allocation recommendations—for example, about the desired composition of the register, the suitability of the investor, the treatment of existing security holders, the price and size of the bid and any role the investor played in the price discovery process.
- 16 For secondary capital raisings, licensees advised there is an implicit understanding that the starting point for the allocation recommendation is to offer existing security holders a pro rata allocation. We found that existing security holders generally received better allocations (as a percentage of what was bid) than non-security holders, but this was not always the case. We also found that existing security holders did not always receive a pro rata allocation.
- 17 We found that licensees provide messages to investors at the commencement of a bookbuild but, given the dynamic nature of transactions, they do not always provide update messages. Where update messages were provided we observed mixed practices in their content and delivery, including the use of words such as ‘covered’ or ‘cornered’.
- 18 We observed a range of compliance arrangements that licensees have in place to monitor and review the allocation process. This is an area where practices can be improved. This includes ensuring that suitable policies and procedures for conducting allocations are used, and there is a review of

messages and periodic reviews of transactions to assess how the policies and procedures are applied in practice.

- 19 We found that it is common among mid-sized licensees for employees of the licensee to receive allocations. Allocations to employees and principal accounts can lead to significant conflicts of interest. Where personal interests take precedence over client interests this may reduce the allocation available for clients and result in poor advice or outcomes for clients. Better practice is to avoid this conflict.

Next steps

- 20 In this report, we highlight practices that licensees should review to ensure they are compliant with Australian legal and regulatory requirements.
- 21 Licensees should consider whether their controls—including policies, procedures, training and monitoring—are appropriate and meet legal and regulatory requirements, including providing financial services efficiently, honestly and fairly.
- 22 Licensees should give careful consideration to the messages provided to investors both during and after transactions to ensure they do not engage in misleading or deceptive conduct or other misconduct.
- 23 Issuers make decisions about how and when to raise capital. They also approve the allocation of securities to investors and may seek advice from independent advisers or other licensees. Issuers should understand the allocation process and ask questions about the rationale for the allocation recommendation proposed by a licensee. Advice may be sought from a licensee or independent adviser.
- 24 We will take enforcement action where we consider there has been conduct that is unlawful under the Corporations Act, *Australian Securities and Investments Commission Act 2001* (ASIC Act) or other applicable legislation that we administer, and which otherwise meets our criteria for enforcement action.
- 25 We will continue to monitor transactions to see how licensees incorporate the better practices in this report into the way they conduct allocations.
- 26 We intend to follow up this report with industry consultation on market practices in debt capital market transactions.
- 27 Feedback on the issues raised in this report is welcome and can be sent to: allocations.report@asic.gov.au.

Note: We will not treat your feedback as confidential unless you specifically request that we treat whole or part of it (such as any financial information) as confidential.

A Australian market for equity allocations

Key points

Australia has an active market for raising equity capital.

Good practice in relation to allocations, including management of conflicts, promotes market integrity and efficiency and increases investor confidence.

In this section we outline:

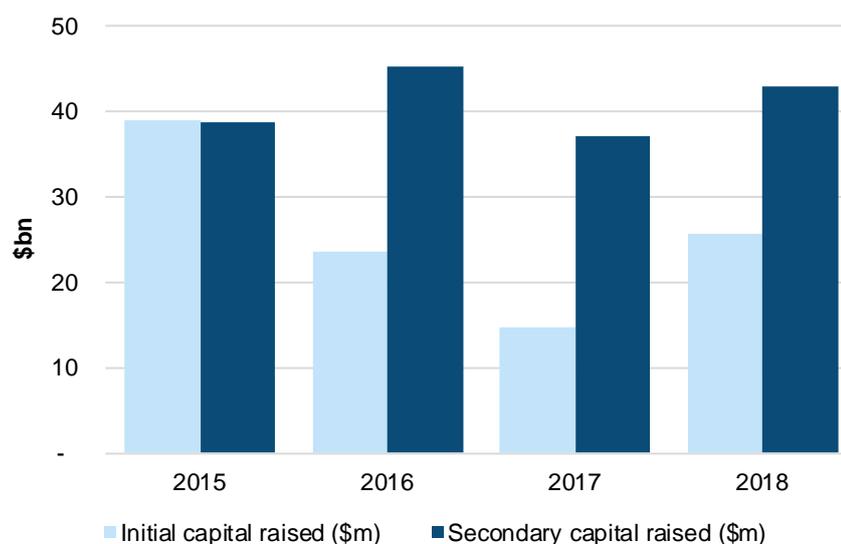
- common transaction types that involve allocations; and
- the key participants in the allocation process and the importance of allocations to them.

Background

28 Australia has an active market for raising equity capital. This plays a key role in the economy and enables companies to raise capital and price and allocate risk.

29 In the period 1 July 2014 to 30 June 2018, ASX figures reveal that a total of \$267 billion of equity capital was raised by companies listed on ASX. This comprised \$103 billion of initial capital and \$164 billion of secondary capital. The amount of initial and secondary capital raised each year during this period is shown in Figure 1.

Figure 1: Capital raised on ASX (years ended 30 June)



Source: ASX 2018 Annual Report (capital raised is the equivalent of capital quoted).

Note: The data and key trends shown in this figure are described in paragraph 29 (accessible version).

30 To understand the extent of any gain from obtaining an allocation, we examined the performance of IPOs and placements in the period from 1 July 2014 to 30 June 2018.

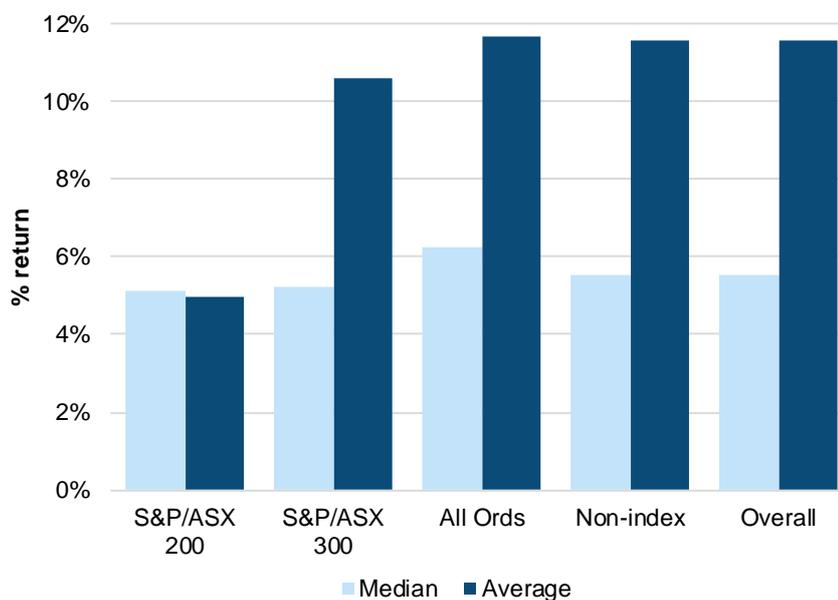
Initial public offers

31 We analysed almost 300 IPOs that raised above \$5 million for issuers that listed on ASX in the period from 1 July 2014 to 30 June 2018.

Note: IPOs by listed investment companies, exchange traded funds, managed funds, foreign exempt issuers, chess depositary interests and demergers are excluded.

32 The issue price was compared to the volume weighted average price for the first day of trading (1D VWAP) following listing. The analysis revealed that, for our sample set overall, the median security price increase was 5.6% and the average security price increase was 11.6%. The median and average 1D VWAP security price performance for various indices are set out in Figure 2.

Figure 2: IPOs: security price performance post listing (1D VWAP) (1 July 2014 to 30 June 2018)



Source: Bloomberg, IRESS and ASIC.

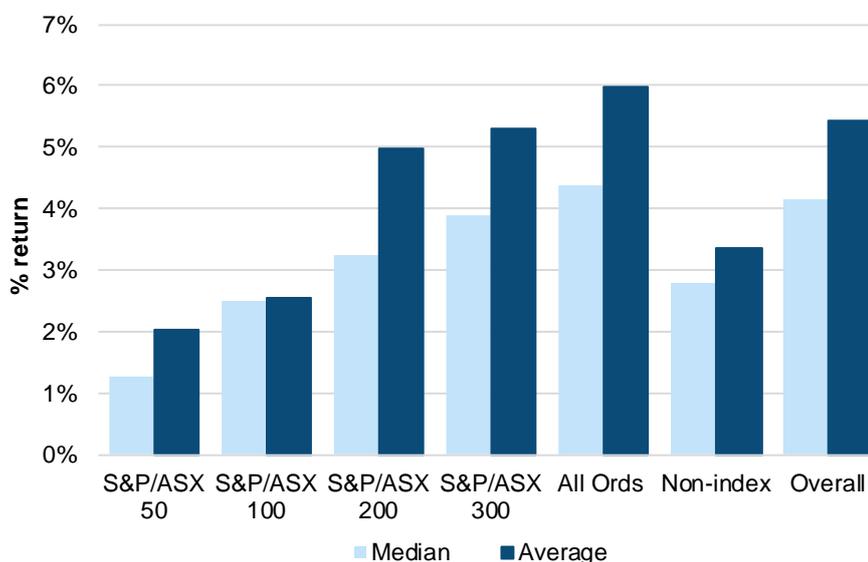
Note: The data and key trends shown in this figure are described in paragraph 32 (accessible version).

Placements

33 We analysed the security price performances of the 200 largest placements (by amount raised) in the period from 1 July 2014 to 30 June 2018 for entities listed on ASX.

34 The price at which placement securities were issued was compared to the 1D VWAP following announcement of the placement. The analysis reveals that, for our sample set overall, the median security price increase was 4.1% and the average security price increase was 5.4%. The median and average 1D VWAP security price performance for the various indices are set out in Figure 3.

Figure 3: Placements: security price performance post announcement (1D VWAP) (1 July 2014 to 30 June 2018)



Source: Bloomberg, IRESS and ASIC.

Note: The data and key trends shown in this figure are described in paragraph 34 (accessible version).

Transactions that involve allocations

35 A range of transactions involve allocations with the most common types set out in Table 1.

Table 1: Common transactions that involve allocations

Transaction type	Description	Who can participate?
Initial public offers	<p>Provides an opportunity to add new investors to build a register, create liquidity and meet the security holder spread requirements of the relevant exchange.</p> <p>The use of a prospectus allows participation by a range of investors, including retail investors. The prospectus often includes an allocation policy which is expressed in general terms and leaves allocation decisions to the discretion of the issuer. Some offers include a priority allocation, for example, to the issuer's employees.</p> <p>Typically, a licensee engaged to manage an IPO will prepare an allocation recommendation for the issuer to approve.</p>	<p>Institutional investors</p> <p>High net worth (HNW) investors</p> <p>Retail investors</p>
Pro rata offers	<p>Eligible security holders are offered the opportunity to acquire securities in proportion to their existing security holding. If the offer is renounceable, security holders may renounce or sell their entitlement on market.</p>	Eligible security holders
Shortfalls from accelerated renounceable pro rata offers	<p>Any entitlements not taken up by existing security holders (after allowing for any oversubscription facility) are offered into a bookbuild to institutional and HNW investors.</p> <p>The licensee prepares an allocation recommendation for the issuer to approve based on investors who offer the highest price to clear any shortfall.</p>	<p>Institutional investors</p> <p>HNW investors</p>
Shortfalls from accelerated non-renounceable pro rata offers	<p>Any entitlements that are not taken up by existing security holders (after allowing for any oversubscription facility) are offered to institutional and HNW investors at the entitlement offer price.</p> <p>The licensee prepares an allocation recommendation for the issuer to approve.</p>	<p>Institutional investors</p> <p>HNW investors</p>
Placements	<p>The price at which securities are offered is either fixed or determined by the level of bids from eligible investors at various price points typically within a range.</p> <p>Usual practice is for the licensee engaged to manage the transaction to prepare an allocation recommendation for the issuer to approve.</p>	<p>Institutional investors</p> <p>HNW investors</p>

Transaction type	Description	Who can participate?
Security purchase plans (SPP)	<p>Eligible security holders can subscribe for up to \$15,000 of securities in a 12-month period (ASX Listing Rule 7.2 Exception 15 and Class Order [CO 09/425] <i>Share and interest purchase plans</i>) and the total amount raised via an SPP is typically subject to a cap.</p> <p>The SPP offer document usually sets out the scale-back policy which is left to the discretion of the issuer.</p>	Eligible security holders
Dividend reinvestment plans (DRP)	<p>Open to eligible security holders who have elected to participate in the DRP in accordance with the DRP rules.</p> <p>The issuer may appoint a licensee to underwrite the DRP, in which case any shortfall is placed to investors arranged by the licensee.</p>	<p>Eligible security holders who have elected to apply</p> <p>Shortfall may be bid for by institutional and HNW investors</p>

Note: Participation is limited to investors in jurisdictions where an offer can be made.

36 The transactions described in Table 1 are usually undertaken on either an underwritten or reasonable endeavours basis by a licensee.

Note: Further information on the different types of risk that may be assumed by licensees is set out in Appendix 2.

37 The terms of the licensee's engagement by the issuer are usually set out in a document which may be referred to as a mandate letter, underwriting agreement or offer management agreement. In this report, we refer to these as the 'terms of engagement'.

Key participants in the allocation process

38 The key participants in the allocation process are issuers, licensees and investors.

39 Some issuers may also engage an independent adviser to provide advice in relation to the transaction and to help with the selection and management of licensees to execute transactions.

Issuers

40 Issuers seek to raise funds on the best terms possible. This should involve consideration of a range of factors, including the issue price and who the new securities are issued to.

41 The objectives of the issuer can depend on its size, stage of development and the composition of its register. For example, an emerging mining company may be seeking patient, long-term investors who can contribute further

capital as it develops its assets. This may result in a greater focus on the nature of the investor rather than the price at which securities are issued. Compare this to a company with an established register with many institutional investors. In this case, the issuer may be more interested in maximising the price at which securities are offered to minimise dilution. This may also be the case where the transaction comprises a vendor sell-down.

42 An issuer may also use allocations as an opportunity to reset or refresh its register by adding institutional investors which may also increase trading liquidity in its securities.

43 The issuer's board of directors is responsible for approving the issue of new securities. In discharging their duties, directors must exercise care and diligence, act in good faith in the best interests of the company, and for a proper purpose: s180, 181 and 184 of the Corporations Act.

Note: An issuer may require equity capital for a range of purposes. These include providing working capital, repaying debt, funding an acquisition or developing an asset, or increasing trading liquidity in the issuer's securities, including the introduction of new security holders to the register.

44 Issuers should also consider the control implications of the transaction structure they select and the allocations they approve.

Note: This is particularly the case with rights issues, where the choice of structure (renounceable versus non-renounceable), shortfall dispersion strategy, and underwriting and sub-underwriting arrangements may either amplify or mitigate the potential control implications: see [Regulatory Guide 6 Takeovers: Exceptions to the general prohibition \(RG 6\)](#) at Section D 'Rights issues' and Section E 'Underwriting'.

45 The issuer may engage a licensee or other advisers with experience in transactions to provide advice about the structure, pricing and terms of a proposed transaction. This typically involves the issuer agreeing terms of engagement, including a provision about how allocation decisions are to be made: see Section C below. The issuer would also be expected to advise the licensee about what it wants to achieve from a transaction.

46 There are a range of factors that an issuer may consider when issuing securities and making allocation decisions. These may include the price and terms at which securities will be issued, who they will be issued to and the likely security price performance following the issue (we refer to this as the 'after-market').

Note: The figures on immediate after-market pricing for transactions in paragraphs 31–34 suggest that issuers may not be considering the terms on which securities are issued as actively as they should.

47 There is no requirement for issuers raising funds in the secondary market to offer new securities to existing security holders: see ASX Listing Rule 7.1.

Rather, this may be one of the factors that issuers consider when determining the choice of offer structure.

- 48 A key role of the issuer in a transaction is to approve the allocation recommendation provided by the licensee and to pass a resolution to issue the new securities.

Licensees

- 49 A key role of licensees is to identify investors to subscribe for new securities for the amount sought to be raised from investors consistent with the issuer's objectives.

- 50 Licensees generate fees from transactions. These are typically paid once the transaction is completed. For many licensees, these fees can form a substantial proportion of their revenue. Licensees may also have financial exposure where they have underwritten a transaction. Allocating securities to investors helps licensees to complete the transaction and reduce any underwriting exposure.

Terms of engagement

- 51 Licensees can be engaged in a range of capacities in transactions, including as lead, co-lead or broker to the transaction. These roles may be on a sole or joint basis and may also include acting as an underwriter. The licensee may be engaged directly by the issuer or may be engaged by another licensee involved in the transaction.
- 52 Where a licensee is directly engaged by the issuer (e.g. lead manager), their role may also include providing advice to the issuer about the structure, pricing, terms, timing and proposed marketing of a transaction.
- 53 In addition to providing financial services to the issuer, licensees (or their related entities who are also licensees) also provide financial services to their investing clients (or potential clients). This can create potential conflicts and licensees need to consider their obligations to the issuer under the terms of engagement. For the purposes of this report, where we refer to licensees we are including references to the activities of any related bodies corporate who are also licensees and are involved in the equity raising transaction.

Joint lead managers

- 54 Where joint lead managers (JLMs) are engaged, it is common for one JLM to manage the compilation of bids from investors from each of the JLMs and prepare a consolidated allocation recommendation. Once this has been agreed by the JLMs it is provided to the issuer to review and approve.

Who undertakes transactions within a licensee

55 Transactions are typically managed by employees who sit within the private (i.e. non-public) side of licensees and are permanently wall-crossed. These areas are often referred to as investment banking, corporate finance, equity capital markets or equity syndication (collectively the 'ECM team'). This arrangement helps licensees to ensure that information about transactions (which may be inside information) is managed appropriately.

Note: Licensees are expected to conduct their business in compliance with the insider trading prohibitions contained in Div 3 of Pt 7.10 of the Corporations Act including, in particular, the provisions relating to procuring in s1042F.

56 Before a transaction is marketed to investors, some employees from the public side of a licensee may become aware of a potential capital raising transaction. For example, an equity sales employee may be asked by the ECM team to provide advice on pricing and institutional investors who are likely to be interested in the offer. In these situations, the licensee's wall-crossing process should be followed and, if the employee has inside information, they should be restricted from providing advice on the issuer until the information becomes generally available.

57 In deciding the structure and timing of a transaction, the ECM team and any wall-crossed employees may undertake market soundings with a small number of investors (who have also been wall-crossed) to test their interest in the transaction. For IPOs, there is often a more extended marketing period and a wider range of investors may be contacted.

Note: Licensees should have a process for wall-crossing investors before conducting market soundings. See [Report 393](#) *Handling of confidential information: Briefings and unannounced corporate transactions* (REP 393) for further information.

58 Once an issuer has decided to proceed with a transaction, the licensee will finalise its terms of engagement with the issuer and prepare to market the transaction to investors. IPOs have a longer marketing period than secondary capital raisings and, once a bookbuild commences, licensees aim to secure interest from investors as quickly as possible to minimise market risk. As a result, allocation recommendations are often prepared under time pressure.

Marketing the transaction

59 Marketing usually commences with a licensee's ECM team briefing its sales desk (or the sales desk of related entities) to provide details about the transaction and providing a deal summary sheet. The sales desk then contacts investors to seek bids for the transaction (the 'bookbuild').

Note: For secondary capital raisings, the sales briefing occurs outside market hours or when the issuer's securities are in a trading halt.

60 During the bookbuild, the ECM team may provide updates to the sales desk about the status of the transaction to be provided to investors. For IPOs, bids may also be received from the general public.

61 Bids from investors are recorded by licensees using a range of methods, including electronic order systems, spreadsheets or in writing. Bids are passed to the ECM team which compiles them and prepares the allocation recommendation. Duplicate bids which may arise if each JLM receives a bid from the same investor or if an investor bids into both the institutional and retail and HNW pools are removed.

The allocation recommendation

62 The allocation recommendation is usually contained in a spreadsheet that includes, among other things, the name of each investor who has submitted a bid, the amount they have bid, whether they are an existing security holder (if applicable) and the proposed allocation for each investor.

63 Other information that may be contained in the allocation recommendation can include a licensee's ranking of an investor and the number of securities allocated as a percentage of the amount bid or as a percentage of an investor's existing security holding. Typically, institutional investors and larger security holders are individually named in the allocation recommendation. Allocations to retail or HNW clients are usually aggregated and shown as a single line item.

64 Receiving an allocation can offer value to investors (see paragraphs 31–34). As a result, licensees may seek to make allocation recommendations to investors who may further the licensee's commercial interests.

65 The allocation recommendation may be subject to the licensee's internal review and approval process, which may include a review by compliance, and discussions between JLMs, where appropriate. Once settled, the allocation recommendation should be sent to the issuer for review and approval.

66 Once the issuer has approved the allocation recommendation, the licensee advises investors of their allocations and the issue price, which they may accept or, in rare cases, reject.

67 To manage any errors or omissions in the allocation process, the licensee may not initially allocate a small number of securities (we refer to this as the 'buffer'). The buffer is used to manage any errors and omissions. If there are any securities remaining in the buffer, they are allocated by the licensee before the new securities commence trading.

Investors

- 68 Benefits to investors from receiving an allocation include:
- (a) an opportunity to acquire securities at a discounted price. To encourage investors to participate in transactions, securities are generally issued at a discount to the prevailing listed peer group or to recent traded prices for a listed issuer's securities;
 - (b) capital growth if the securities are expected to quickly trade above their issue price in the secondary market. The capital growth is likely to be greatest for keenly sought-after transactions or industry sectors;
 - (c) the ability to acquire a sizeable number of securities without having to bid for them on-market where they may have to pay a higher price for the securities; and
 - (d) the ability, in secondary capital raisings, for existing security holders to avoid dilution to their existing security holding.
- 69 Investors provide feedback to licensees and the issuer about transactions and submit bids into the bookbuild. This is usually in response to a request from a licensee involved in the transaction and may assist with the price discovery process.
- 70 At times, select institutional investors may be contacted by a licensee to assess whether they would be prepared to invest in a transaction. This may include agreeing to act as a cornerstone investor or as a sub-underwriter which can help to reduce the market risk of a transaction. If this relates to a secondary capital raising or an IPO which may impact the price or value of listed securities, investors should be wall-crossed.
- 71 Institutional investors may be asked to bid at a fixed price or at various price steps. Bids from retail investors and HNW investors are generally only sought at the final issue price.

B Scope of the review

Key points

Our review focuses on market practice for the allocation of securities in transactions in the Australian market.

We consulted with a wide range of parties who are involved in the allocation process.

A number of transactions of different types and sizes were reviewed to see how allocation decisions are made in practice.

Key focus areas

- 72 This report examines market practice for the allocation of securities in transactions in Australia.
- 73 We were interested to understand:
- (a) how licensees conduct allocations and meet their regulatory obligations, including managing conflicts of interest and providing financial services efficiently, honestly and fairly;
 - (b) the role of the issuer in the allocation process; and
 - (c) whether current regulatory settings are appropriate and if new or updated regulatory guidance is required.
- 74 If conflicts are not managed appropriately, there is a risk that breaches of financial services law may occur. For example, market manipulation, misleading and deceptive conduct, and breaches by licensees of their general obligations: see Appendix 3 for a summary of the relevant legislative provisions.
- 75 This section considers the following key areas:
- (a) how allocation decisions are made and what factors are considered;
 - (b) the role of compliance in allocations;
 - (c) the messages licensees provide to investors both during and following transactions; and
 - (d) how allocations are made to persons connected to the licensee (e.g. related investment managers, employees and principal accounts).

What we did

- 76 We engaged with institutional investors, licensees, independent corporate advisers, issuers, industry associations and international regulators to understand their approaches to, and experiences with allocations in transactions.
- 77 We examined the policies, procedures and practices of a range of large and mid-sized licensees to understand how they manage allocations.
- Note: In this report, ‘large licensees’ refers to licensees (mostly investment banks with an offshore parent), who typically advise on transactions raising over \$100 million. ‘Mid-sized licensees’ refers to licensees that are usually domestically owned and operated, and generally advise on transactions raising less than \$100 million.
- 78 We also reviewed 16 transactions, including IPOs, shortfall bookbuilds for pro rata offers and placements, that were of varying sizes and involved a range of licensees and industry sectors.
- 79 For each transaction, we reviewed the allocation schedule and discussed the approach to allocations with the licensees involved in the transaction. We also met with a selection of issuers or their independent advisers to understand their involvement in the allocation process for the transactions we reviewed.

How we did it

- 80 Table 2 sets out the methodology adopted for our review.

Table 2: Methodology

Thematic review of large and mid-sized licensees	<p>We reviewed policies and procedures and met with licensees who manage transactions to assess their process and controls for allocations.</p> <p>Information was sought on:</p> <ul style="list-style-type: none"> • the objectives of the transaction; • the involvement of the issuer; • the factors that are considered (and not permitted to be considered) in making allocation recommendations; • the process for recommending allocations for different types of investors; • any differences in practices for initial and secondary capital raisings; • any differences in practices for underwritten and non-underwritten transactions; • the messages provided to investors; • licensee record-keeping of allocation recommendations; • the approach to allocations to related investment managers, employees and principal accounts; and • the role of compliance within licensees.
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Institutional investors	<p>We met with several institutional investors of different sizes, investment styles and geographic locations who participate in transactions.</p> <p>Information was sought on their experiences with allocations, including:</p> <ul style="list-style-type: none"> • any differences between initial and secondary capital raisings; • messages received from licensees during marketing and following completion of transactions; • the role of the issuer in the process; • steps investors can take to improve their allocation; • views on allocations to employees and principal accounts; and • suggestions for improvement to the process.
Issuers (or their independent advisers)	<p>We met with a selection of issuers or their independent corporate advisers to understand their involvement in the allocation process.</p>
Transaction review	<p>We examined 16 transactions over the period from September 2017 to September 2018. This covered a range of transaction types, including IPOs, shortfall bookbuilds for pro rata offers and placements of varying size, involving a range of licensees and industry sectors.</p> <p>We reviewed the allocation schedules, discussed the approach to allocations with a range of licensees and met with a selection of issuers or their independent advisers to understand their involvement in, and perspectives on, the process.</p> <p>The transaction review focused on:</p> <ul style="list-style-type: none"> • the objectives of the transaction; • the involvement of the issuer in the allocation process, including reviewing and approving the allocation recommendation; • messages provided to investors during the transaction; • a review of the bids and allocations to understand the rationale for allocation decisions; • the treatment of existing security holders in secondary capital raisings; and • the size of allocations to related investment managers, employees and principal accounts of licensees involved in transactions and how these are disclosed to issuers and investors.

C How licensees make allocation recommendations

Key points

This section outlines our findings on how licensees make allocation recommendations.

It covers the following key areas:

- the role of policies and procedures;
- the objectives of the transaction;
- investor types; and
- investor bidding.

We also consider the role of compliance in the allocation process.

This section also outlines better practices to help licensees meet their regulatory obligations.

- 81 This section sets out our findings on how licensees make allocation recommendations. They are based on meetings with a wide range of stakeholders. We focus on allocations to institutional investors and also include some observations about allocations to retail investors and HNWI investors.
- 82 We found that licensees consider a range of discretionary factors when making allocation recommendations to issuers.
- 83 The terms of engagement generally include a term about who makes allocation decisions. We found this is often a matter for negotiation between the issuer and the licensee. Commonly used clauses include: allocations will be determined by the licensee ‘in consultation with’ or ‘in agreement with’ the issuer. We were also made aware of terms of engagement that included a specific clause giving the issuer final say over allocations.
- 84 Licensees advised that, notwithstanding the terms of engagement, they work collaboratively with the issuer to finalise allocations. Even where a licensee has entered a hard-underwriting agreement, they generally agree with changes to the allocation recommendation suggested by the issuer (provided the changes do not materially increase the licensee’s underwriting risk).

Note: The power to issue new securities is vested in the issuer: s124 of the Corporations Act. The board resolution may annex an allocation recommendation prepared by the licensee; however, the directors must consider their duties when approving that issue of securities. Also see the better practices for issuers set out in D2.

- 85 For initial capital raisings, the prospectus often includes a statement about the allocation policy that will be applied in allocating securities applied for under the offer. The comments are usually general in nature and leave the decision to the discretion of the issuer, who may seek input from the lead manager or underwriter.

Policies and procedures

- 86 We found that most large licensees have allocation policies that set out criteria relevant to making allocation recommendations to issuers. These include:
- (a) acting in the best interest of the issuer, including preventing or managing conflicts of interest;
 - (b) considering the issuer's objectives and preferences, including the type, size and geographic spread of investors;
 - (c) maintaining reasonable price stability and liquidity in the after-market;
 - (d) the timing, price and size of bids received and consistency with the investment strategy of the investor or the size of their fund;
 - (e) the level of demand received for the offer;
 - (f) for secondary capital raisings, the investor's existing security holding in the issuer;
 - (g) the licensee's knowledge and experience with the investor in previous transactions, including how long the investor typically holds securities;
 - (h) the level of engagement by the investor with the issuer, including whether the investor was wall-crossed and helped with the price discovery process;
 - (i) the overall business relationship between the investor and the licensee;
 - (j) any legal or regulatory restrictions on an investor's participation; and
 - (k) whether the investor is using an allocation to build a strategic position.
- 87 We found that these criteria act as guidelines, are not prioritised, and are subject to the discretion of the licensee.
- 88 Most of the allocation policies we reviewed also set out criteria that should not be considered when making allocation recommendations, including:
- (a) allocations to investors in exchange for a commitment to engage in after-market buying (laddering) or agreeing to participate in a subsequent transaction;
 - (b) allocations to senior management or directors of other companies that the licensee is seeking to secure corporate business from in future (spinning);

- (c) allocations in return for excessive compensation from an investor for other services (*quid pro quo* arrangements); and
 - (d) profit-sharing arrangements with an investor in return for an allocation.
- 89 Some policies also set out guidelines for the process a licensee should follow when conducting a transaction, including:
- (a) the process for providing messages to investors about the status of a transaction;
 - (b) keeping the issuer informed about the status of a transaction;
 - (c) the internal process for approving the allocation recommendation before it is provided to the issuer;
 - (d) the approach to allocations to related investment managers and employees and principal accounts;
 - (e) record-keeping requirements; and
 - (f) compliance arrangements.
- 90 Mid-sized licensees generally seek to rely on general provisions in other policies (e.g. conflicts of interest and employee trading policies) rather than having a specific allocation policy. We note that some aspects of these policies have application to allocations, but they do not specifically address the wider range of conduct involved in making allocation recommendations.
- 91 A number of mid-sized licensees advised that they are in the process of reviewing policies and looking to implement a separate allocation policy as a result of ASIC's recent focus on this area.
- 92 We observed that licensees may at times record some general comments about the approach to allocations, but it was not common for the rationale for the allocation proposed to each investor to be recorded.

Better practices for licensees

- c1** Licensees should have a policy and procedures that set out their process for managing allocation recommendations for transactions.

The allocation policy and procedures should consider a range of factors to ensure a fair and efficient allocation process and avoid or minimise potential conflicts.

Better practices for licensees include:

- (a) engaging with the issuer at various stages during the transaction, including:
 - (i) at pitching and negotiation of the terms of engagement to understand the issuer's objectives, including discussion about:
 - (A) the type, size and location of investors who may participate in the transaction;

- (B) consideration of the approach to allocations for institutional investors with different investment styles (e.g. how to treat passive investment funds); and
- (C) for secondary capital raisings, the treatment of existing security holders;
 - (ii) at various stages during the transaction, including discussing feedback from marketing; and
 - (iii) discussing the allocation recommendation and the reasons why allocation recommendations have been made;
- (b) placing the objectives of the issuer as the primary consideration for licensees when making allocation recommendations. For example, a business relationship between the licensee and an investor should not take precedence over the objectives of the issuer;
- (c) identifying and managing potential conflicts of interest, for example disclosing them to the issuer and explaining how they are being managed;
- (d) including criteria that the licensee may consider, and should not consider, when making allocation recommendations and setting out the priority in which they are applied;
- (e) an internal process for approving allocation recommendations before they are provided to the issuer;
- (f) record-keeping requirements for allocation recommendations, including:
 - (i) the name of each investor who bid for securities;
 - (ii) the number of securities they bid for;
 - (iii) whether they are an existing security holder;
 - (iv) the number of securities they were allocated;
 - (v) the reasons for making an allocation recommendation that certain investors or class of investors receive a disproportionately larger or smaller allocation relative to other investors or classes of investors; and
- (g) setting out the role of a licensee's compliance or another control function in monitoring compliance with allocation policies and procedures.

Note: Also see the better practices outlined in C2 in relation to the role of compliance and in F1 and F2 in relation to allocations to related investment managers, employees and principal accounts.

Objectives of the transaction

- 93 Licensees noted that a key objective of a transaction is to allocate securities to investors in a manner consistent with the issuer's objectives and recognise investors who assist in price discovery or in reducing the risk of a transaction.

Issuer objectives

- 94 In addition to raising the funds sought, we noted that the objectives of the issuer may include adding new long-term institutional investors to the register, to provide or increase liquidity, broadening the investor base and maximising the price at which securities are issued.
- 95 We observed examples of specific requests from issuers in relation to allocations, including:
- (a) allocating to long-term investors who understood the risks of an early-stage mining company;
 - (b) setting a percentage of the offer to be allocated to the top 20 security holders;
 - (c) requesting that certain investors be allocated 100% of their bid as the issuer believed they were long-term investors who understood its business;
 - (d) a request to allocate a small portion of the IPO to friends and family of the issuer (often referred to as the 'Chairman's list');
 - (e) for a secondary capital raising, a requirement that the licensee contact the existing top 20 security holders to guarantee them a pro rata allocation; and
 - (f) requesting a licensee to allocate securities to investors who were (or were likely to become) customers of the issuer.
- 96 At times, an issuer wants to recognise support provided to it from a licensee who has not been engaged to manage the transaction. In these circumstances, the issuer may request the lead manager or JLMs to provide a small allocation of securities to the other licensee for distribution to its clients.

Reducing transaction risk

- 97 Many licensees noted that institutional investors play a key role in the price discovery process, particularly for IPOs.
- 98 Before an offer is launched, institutional investors may be contacted by a licensee to provide an indication of the price and volume of securities they are interested in acquiring. This may result in the investor entering an agreement to acquire securities (e.g. as a cornerstone investor), agreeing to act as a sub-underwriter or providing an indication of their interest in the transaction without a formal commitment to acquire securities being entered.

Note: Also refer to comments in paragraph 57 relating to wall-crossing of investors.

- 99 Early investor support can increase the likelihood that a transaction will be successful by signalling confidence in the offer to other investors and assisting a licensee's decision to underwrite a transaction.
- 100 Licensees advised that where an investor acts as a sub-underwriter or is wall-crossed, this does not guarantee the investor a favourable allocation. There is, however, an acknowledgement that investors who help with price discovery will be recognised favourably in the allocation process. Licensees also advised that wall-crossed investors are usually selected because they are considered most likely to bid for securities in the transaction.
- 101 Once marketing for a transaction commences, licensees noted that investors who bid early and in size (aggressive bidding) can help to generate momentum in the bookbuild and provide a signal for other investors to bid. Aggressive bidding can also help to reduce the risk of a transaction and aid the efficiency of the equity raising process. For secondary capital raisings, licensees advised that aggressive bidding is often considered in making allocation recommendations, irrespective of whether the investor is an existing security holder of the issuer.
- 102 Some investors commented that aggressive bidding should not be considered in making allocation recommendations. In secondary capital raisings, some institutional investors expressed concern that aggressive bidding could be used to justify allocating securities to non-security holders and dilute existing security holders. It was noted that some institutional investors need time to follow their internal processes or may wish to talk to the issuer before submitting a bid. Also, some institutional investors may have limits in their investment mandates as to how they can bid (e.g. passive investment funds may only be able to bid for their pro rata allocation and not engage in aggressive bidding). We also saw examples of institutional investors who engaged in aggressive bidding placing pressure on licensees to reduce their proposed allocation where a transaction was not strongly supported.

Underwritten transactions

- 103 We found no material difference in the way allocation recommendations were made depending on whether a transaction was underwritten, irrespective of the type of underwriting.
- 104 We did, however, see examples of licensees making more favourable allocation recommendations to investors who acted as sub-underwriters and reduced the licensee's underwriting exposure.

Investor types

105 We observed that licensees consider the type or nature of an investor in preparing the allocation recommendation. This may include the suitability of the investor for the issuer, the treatment of existing security holders, the ranking of investors by the licensee and the level of engagement by the investor in relation to the transaction.

Suitability of the investor

106 Licensees advised that they consider an investor's investment strategy, size of fund and investment mandate when making allocation recommendations. These factors and a licensee's knowledge of an investor can help in determining whether the investor is suitable for the issuer.

107 We observed that institutional investors who actively trade (e.g. hedge funds) may be scaled back by more than long-only institutional investors due to an expectation that they may have a short-term investment outlook. However, it was noted that not all actively traded funds have this outlook and if they have played a role in price discovery or generating momentum to a transaction, this is considered in making allocation recommendations. It was also noted that some institutional investors who a licensee considers to be long-only may sometimes dispose of their holdings quickly in the after-market, particularly if the price has risen above the issue price.

108 Some licensees advised that they consider whether the issuer is likely to move into a new index when making allocation recommendations. For example, if a transaction results in the issuer being likely to meet the criteria for inclusion in the S&P/ASX 100 index, some licensees advised that they are likely to allocate fewer securities to an investor with an ex S&P/ASX 100 index investment mandate as they are considered more likely to sell the securities quickly in the after-market.

Existing security holders

109 The terms of engagement for secondary capital raisings do not generally specify how existing security holders are to be treated. We did, however, see an example of terms of engagement where the issuer required the licensee to use its best endeavours to contact the issuer's top 20 existing security holders and offer them a pro rata allocation.

110 Licensees advised that in secondary capital raisings there is an implicit understanding that the starting point is to offer existing security holders a pro rata allocation. Some licensees advised they do this by first allocating securities to larger existing security holders on a pro rata basis. They also advised that if existing security holders bid for more than their pro rata

allocation, the licensee treats any bid above the pro rata allocation in the same manner as bids from non-security holders.

- 111 From our transaction review, we observed that existing security holders did not always bid, particularly where the issue price represented only a small discount to the prevailing market price of the issuer's securities.
- 112 For secondary capital raisings, it was common for the issuer to commission an analysis of its register to determine the underlying beneficial security holders. These reports, which are usually made available to the licensee, are often limited to a fixed number of security holders (e.g. the top 50), often include recent trading by these security holders and are usually prepared shortly before the transaction is marketed to investors. This information can help the licensee and the issuer to identify existing security holders and assess the impact of allocation decisions on them.
- 113 For the secondary capital raisings that we reviewed, existing security holders generally received better allocations (as a percentage of what they bid) than non-security holders, but this was not always the case.
- 114 We saw an example where the aggregate number of securities allocated to the top 50 existing security holders was more than would have been required to provide them each with a pro rata allocation. However, not all of the top 50 received a pro rata allocation as the issuer approved allocations to a few existing security holders that were significantly more than their pro rata allocation. As a result, other existing security holders received less than their pro rata allocation.
- 115 We observed that transactions where existing security holders received less than their pro rata allocation generally occurred where the issuer (who often had an independent adviser) was actively involved in the allocation process. We observed one transaction where the issuer used this as an opportunity to introduce new institutional security holders to the issuer's register.
- 116 Some institutional investors were concerned that not offering a pro rata allocation to existing security holders in a placement (which are generally offered at a discount to the prevailing market price) would transfer value to new investors and dilute their voting power. Nonetheless, we observed a placement where a cornerstone investor, who was not an existing security holder, paid a higher price per security than other investors in the transaction.
- Note: ASX Listing Rule 7.1 also limits the amount of securities that a listed entity can place to investors to 15% of its issued capital in any 12-month period without security holder approval unless an exception applies (e.g. a pro rata issue).
- 117 We saw instances where some existing security holders identified on the beneficial holder report did not have an account with the licensee managing the transaction. In these cases, the licensee worked with the issuer's registry

to enable the investor to participate. Where the investor could not be contacted or there were jurisdictional issues with their participation the investor did not receive an allocation.

Passive investment funds

- 118 We observed that passive investment funds (e.g. index funds) do not generally participate in IPOs and for secondary capital raisings they are generally limited, by their investment mandate, to bidding for their pro rata allocation.
- 119 We received feedback that passive investment funds who were existing security holders who limited their bid to their pro rata allocation may be allocated fewer securities than other security holders who bid more than their pro rata allocation.

Ranking of investors by licensees

- 120 Most licensees rank investors into tiers based on a range of factors, including:
- (a) the size and nature of the investor;
 - (b) the amount of commission and other fees the investor pays to the licensee; and
 - (c) how active the investor has been in supporting previous transactions that the licensee has been involved in.
- 121 Licensees advised that these tiers are considered when making allocation recommendations, with investors in the higher tiers generally being recommended for higher allocations than investors in lower tiers. We observed an example of a licensee who recommended that investors with similar ranking receive similar allocations despite each investor bidding for a different number of securities.
- 122 Where licensees rank investors, we were advised that employees involved in preparing allocation recommendations (typically the ECM team) are not aware of the rankings. Despite this, these employees would be expected to understand the relevant importance of investors based on their market knowledge and experience from previous transactions that the licensee has managed.
- 123 Licensees noted that draft allocation recommendations may be reviewed by employees outside of the ECM team (e.g. compliance or the Head of Equities) but the final decision on the allocation recommendation provided to the issuer was made by the ECM team.

Investor engagement

- 124 We found that institutional investors can undertake a number of activities to demonstrate their interest in the issuer which can have a positive effect on the allocations they receive.
- 125 The licensee plays a key role in arranging meetings and site visits between potential institutional investors and the issuer. In addition, the licensee may arrange for institutional investors to meet with its research analyst and discuss any investor education report they have prepared: see RG 264.
- 126 Institutional investors commented that at times they feel obliged to attend meetings to discuss the investor education report or participate in the price discovery process to secure a reasonable allocation.
- 127 It is also common for the issuer to provide feedback to the licensee about interactions it has had with investors. Licensees commented that this feedback and other engagement with the issuer can indicate an investor's interest in the issuer which is considered in making allocation recommendations.
- 128 Secondary capital raisings are usually undertaken in a short timeframe, with less time for the issuer to engage with investors once marketing has commenced. Licensees noted that the issuer often provides them with feedback about previous engagement or contact it has had with investors so that they can be contacted by the licensee.
- 129 We also noted:
- (a) a shortfall for a non-renounceable pro rata offer where a buffer remained unallocated shortly before the close of the offer. The licensee and issuer agreed that the unallocated buffer be allocated to a small number of investors who had expressed interest in investing in the issuer even though they were not existing security holders. Given that the buffer represented a very small percentage of the amount being raised, the licensee and issuer determined it would be impractical to reallocate the buffer to other investors who had already been sent paperwork for the shortfall; and
 - (b) it was uncommon for an institutional investor to receive a zero allocation in a transaction. When this occurred, explanations included that the institutional investor was unknown to the issuer or licensee, the investment style was inconsistent with the objectives of the issuer or the proposed allocation would be small and would likely be sold quickly in the after-market.

Investor bidding

The price an investor offers

- 130 The issue price for a transaction may be determined through an auction process (e.g. a bookbuild for renounced rights in an accelerated renounceable pro rata offer). We observed that allocation recommendations for these transactions were only made to investors who bid at the bookbuild clearing price with investors who bid below this price being excluded.

Size of the bid

- 131 The size of an investor's bid can positively impact on the allocation recommended for that investor. For example, we observed that investors who submitted large bids generally received the largest allocations (by dollar amount) but at times they received lower allocations as a percentage of the amount bid compared to other investors.
- 132 Licensees need to consider whether bids submitted are appropriate. For example, we observed that:
- (a) licensees' ECM teams generally accept bids from the sales desk at face value. This can create concerns if the bid is excessive and taken into account when providing feedback to investors about the status of the offer (see Section E); and
 - (b) a large institutional investor informed a licensee's sales desk that it was seeking an allocation of a certain dollar amount in a transaction. The institutional investor left it to the discretion of the sales person at the licensee to determine the size of the bid that was entered into the bookbuild and provided to the ECM team.
- 133 Licensees should take into account their knowledge of investors to determine if an investor's bid is excessive (e.g. if the bid represents a large proportion of the investor's funds). Where a bid appears excessive, the licensee should discuss it with the investor before it is submitted to the ECM team. This will reduce the likelihood that an inflated view of investor demand is generated and communicated by the licensee to other investors.

Small allocations

- 134 Licensees advised that, if after initial scale-backs, an institutional investor would receive a very small allocation, the licensee may exclude the institutional investor from the allocation recommendation as they consider the allocation not meaningful and likely to be sold in the after-market.

Under allocations

135 Licensees advised that in making allocation recommendations they may allocate slightly less than an investor's desired holding in the issuer in the expectation that the investor will acquire additional securities in the after-market. Licensees expect that this additional buying may increase liquidity for the issuer's securities in the after-market.

Approach to retail investors and HNW investors

136 We observed a common process for retail and HNW bids and allocations for IPOs:

- (a) The ECM team contacts the licensee's private client advisers to understand the likely level of interest from their clients. If this occurs before the prospectus is lodged, retail investors cannot be contacted to discuss the offer (s734 of the Corporations Act) and advisers are required to estimate the likely demand from their retail clients.
- (b) Each adviser then totals the likely demand from their clients and provides this to the head of desk (which may be via the state manager). Individual adviser bids are then aggregated and provided to the ECM team.
- (c) The ECM team then determines how many securities to allocate to the licensee's retail network and advises the head of desk who determines the allocation for each private client adviser (or they may advise each state manager of the allocation and the state manager then determines the allocation for each private client adviser). Factors considered include the size of the bid received from the adviser, the track record of the adviser and the nature of their clients. Each private client adviser then uses their discretion to determine how the securities they have been allocated are split among their clients. Where there is strong demand for an issue, we observed that licensees may impose a cap on the value of securities allocated to any one client.

137 If there are multiple licensees involved in an IPO, a similar process occurs where each JLM makes a recommendation to the issuer of the aggregate amount of securities that they propose should be allocated to their retail network, if applicable.

138 A similar process is applied for placements, but participation is limited to HNW investors.

139 Licensees also advised that for well-supported IPOs there is typically no allocation available for the general public, as securities are allocated to institutional, retail and HNW clients of the licensees named in the

prospectus. The allocation to retail and HNW clients of the licensee is often referred to as a broker firm allocation.

Role of compliance

- 140 We expect licensees to have suitable controls in place to ensure that the allocation process is conducted in accordance with regulatory requirements.
- 141 This includes policies and procedures that are suitable given the nature, scale and complexity of the licensee: see the better practices outlined in C1. Training should be provided to employees about the policies and procedures and there should be appropriate monitoring and review processes for the licensee's conduct in relation to allocations.

Key findings

- 142 We observed a range of compliance arrangements that licensees have in place to monitor and review the allocation process.
- 143 Most licensees have specific allocation policies and arrangements for wall-crossing employees and investors. These arrangements are usually managed by compliance or another control function.
- 144 To minimise the risk of misleading and deceptive information being provided to investors, some licensees have employees from compliance physically present in the trading area when the sales desk is briefed by the ECM team and for a period following the briefing to monitor calls to investors.
- 145 Most large licensees require legal or compliance to approve all written messages before they are provided to investors and undertake reviews of electronic communications either in real time or post transaction.
- 146 We noted that some licensees undertake post-transaction testing to ensure compliance with their policies and procedures. Some licensees select transactions on a periodic basis and review communications and records to test for compliance with their policies and procedures.
- 147 We also observed that licensees that permit allocations to employees usually require written approval from compliance (or in some instances senior management of the licensee) before submitting a bid.
- 148 Some licensees conduct periodic reviews of private client advisers to check how allocations were made to their clients, any allocations to employees and principal accounts and compliance with any allocation caps imposed for a transaction.

Better practices for licensees

- C2** Licensees should clearly articulate and document the role of compliance (or an equivalent review function) in the allocation process.

Licensees should consider how they ensure they are complying with their regulatory obligations on an ongoing basis.

Examples of compliance activities that licensees may undertake in relation to the allocation process include:

- (a) compliance staff attending the sales briefing at the launch of a transaction;
- (b) reviewing any messages (including update messages) provided to investors;
- (c) surveillance of electronic communications;
- (d) selecting transactions for periodic review to check for compliance with the licensee's policies and procedures; and
- (e) training on the licensee's policies and procedures with a focus on real-world examples.

There should be meaningful consequences for individuals who breach a licensee's internal policies and procedures.

D Licensee engagement with the issuer

Key points

This section outlines our findings on the level of involvement of issuers in the allocation process.

We look at the various stages when issuers are involved and set out better practices for both licensees and issuers to consider.

Our review revealed that while issuers are generally interested in the outcome of allocations, their levels of engagement in the allocation process vary.

- 149 The level of involvement in allocations by the issuer is often dependent on their experience with transactions or whether they have strong views about allocations to individual investors or groups of investors.
- 150 While most issuers are interested in the outcome of allocations we noted that some issuers may have little involvement and rely on the allocation recommendation provided by the licensee.
- 151 Key phases where a licensee may discuss allocations with the issuer include:
- (a) pitching;
 - (b) negotiating the terms of engagement;
 - (c) marketing; and
 - (d) after the allocation recommendation is provided to the issuer for review and approval.

Pitching

- 152 When pitching for a role, we were advised that licensees typically only provide a broad overview of their approach to allocations to the issuer. A detailed discussion does not usually occur until the licensee has been appointed by the issuer.
- 153 For IPOs, we noted that there is typically a general discussion about the proposed split between retail and institutional investors and their geography. We observed that licensees with large numbers of retail clients usually recommended a higher percentage of securities be allocated to retail investors compared to licensees with a focus on institutional investors. For secondary capital raisings, there may be discussion about the objectives of the transaction and the treatment of existing security holders.

Negotiating the terms of engagement

- 154 The terms of engagement typically provide that allocations are determined ‘in consultation with’ or ‘in agreement with’ the issuer: see Section C. We were advised that this clause is often the subject of negotiation between the issuer and the licensee.
- 155 During negotiations, and before marketing begins, there is often discussion between the issuer and licensee about what the issuer seeks to achieve from the transaction and the distribution strategy that the licensee proposes.

Marketing

- 156 Once marketing of a transaction occurs, we noted that the issuer often provides feedback to the licensee about investor meetings it has held, the names of investors who have contacted it and the names of any investors it would like to add to its register.

Allocation recommendation

- 157 Issuers typically become most actively involved in allocations when the licensee provides them with the allocation recommendation for review and approval. This is usually followed by a meeting or call between the licensee and the issuer (often represented by their CEO, CFO or board directors) to discuss the allocation recommendation.
- 158 This may involve a line-by-line discussion of each allocation proposed for institutional investors and the rationale for these allocations. We were advised that this often results in some amendments to the allocation recommendation to reflect feedback from the issuer.
- 159 The proposed allocation to retail investors and HNW investors is usually recorded in the allocation recommendation as an aggregate figure and the names of the underlying clients are not provided.
- 160 We observed mixed practices in relation to the level of disclosure to the issuer in the allocation recommendation about any allocations provided to employees and principal accounts: see Section F.
- 161 Once the final allocations are agreed with the issuer, the board approves the issue of new securities to those investors.

Better practices for licensees

D1 We encourage licensees to:

- (a) discuss and set out in writing the approach to allocations with the issuer at various stages during the transaction. This may include providing the issuer with a copy of the licensee's allocation policy;
- (b) identify conflicts in relation to allocations, disclose them to the issuer and explain how they are to be managed;
- (c) have a reasonable basis for allocation recommendations and ensure they are consistent with the issuer's objectives;
- (d) provide issuers with information about the bids submitted, the investors who have submitted these bids and the rationale for the allocation recommendation. This information should be accurate and not misleading or deceptive; and
- (e) disclose to the issuer details of any proposed allocations to employees or principal accounts of the licensee and its related entities and the rationale for these allocations. These allocations should be separately disclosed and not aggregated with other investors.

Note: Also see the better practices for allocations to employees and principal accounts set out in F2.

Better practices for issuers

D2 Issuers are encouraged to understand and engage with the allocation process. This could include:

- (a) discussing the approach to allocations with the licensee at various stages during a transaction (e.g. pitching, marketing and when the allocation recommendation is provided by the licensee);
- (b) for secondary capital raisings, considering the treatment of existing security holders (including passive investment funds) in allocation decisions;
- (c) for rights issues, considering the potential control implications of the offer structure, shortfall mitigation strategy and underwriting arrangements;
- (d) considering the inclusion of a provision in the terms of engagement about how allocation decisions are made and approved, including a clear statement of the role of the issuer in the allocation process;
- (e) asking the licensee to provide a copy of their allocation policy;
- (f) asking the licensee to explain how the allocation recommendation is consistent with their allocation policy and the issuer's objectives;
- (g) asking the licensee questions about the allocation recommendations, including:
 - (i) the rationale for the allocation recommendation;

- (ii) details of proposed allocations to employees and principal accounts and the rationale for these allocations; and
 - (iii) details of proposed allocations to related investment managers; and
- (h) scrutinising and querying the basis for any advice or statements in draft ASX announcements about the transaction, in particular about the nature and level of demand from investors. The use of overly expressive language should be avoided.

E Messages to investors

Key points

This section outlines our findings on messages provided by licensees to investors in connection with transactions. This includes:

- messages provided when marketing begins;
- any update messages provided during the bookbuild; and
- feedback provided to investors following the allocation process.

We also outline feedback on the content of any ASX announcements released by issuers about the nature and level of demand from investors for a transaction.

The section sets out better practices in relation to messages by licensees and issuers in connection with transactions.

- 162 Licensees and issuers often provide messages to investors about transactions, which can help them make investment decisions.
- 163 Messages are often provided about the level of demand and likely price at which securities will be issued during the marketing of a transaction and after allocations are determined.
- 164 Poor conduct around messages provided to investors during marketing about the status of an offer, or after the offer closes about the level of demand and extent of any scale-backs, may breach prohibitions in Pt 7.10 of the Corporations Act and Pt 2 of the ASIC Act relating to misleading and deceptive conduct.
- 165 Issuers also need to be mindful of these requirements when making statements in market announcements about the level of demand for a transaction and consider their continuous disclosure obligations: see s674 of the Corporations Act and the requirements of the relevant exchange (e.g. ASX Listing Rule 3.1).

Messages from licensees

- 166 Licensees contact eligible investors to seek bids for transactions. This is usually undertaken by the licensee's sales desk which has received a briefing by the licensee's ECM team. There are some differences in approach across the licensees we sampled.

At commencement of marketing

167 At the commencement of marketing, the sales desk typically sends eligible investors an electronic message setting out key information about the offer (initial message). This information is usually prepared by the ECM team, goes through an internal review process (which may include review by legal counsel and the issuer) and is sent to eligible investors at around the same time.

Update messages

168 During the marketing of an offer, the licensee may decide to provide a formal update message about the level of demand and the likely price at which securities will be issued (update message).

169 The update message may include a comment by the licensee that the offer is ‘covered’, ‘well covered’, ‘cornered’, or similar wording. These terms are intended to give confidence to investors that an offer has been well received.

170 We found that licensees and institutional investors interpret ‘covered’ to mean that total bids have been received from investors that are capable of being allocated (allocable demand) for at least the total amount being sought under the offer.

171 Some licensees advised that they also use the term ‘well covered’ in updates. Most licensees understood ‘well covered’ to mean that the transaction has received bids for twice or more than twice the amount being sought. Other licensees noted that 1.2 to 1.5 times the amount being sought could be ‘well covered’ if the bids were from high-quality institutional investors.

172 Most institutional investors advised us that they want to know if a transaction is ‘covered’ as it indicates the level of investor support for a transaction and, more importantly, means that the licensee will not be left holding shortfall securities in the after-market. Other institutions commented that they do not rely on messages from licensees and make their own assessments of the merits of an offer.

173 In determining the level of allocable demand, we found that the ECM team accepts bids submitted by its sales desk at face value, relying on the sales desk to ensure these bids are capable of acceptance in full, and excludes bids from related investment managers, employees and principal accounts.

174 We observed the following practices regarding update messages:

- (a) update messages are not always provided, and this can depend on the offer type, size and level of demand;

- (b) some licensees adopt a formal process for update messages (including approval by a senior employee in the ECM team), whereas other licensees have no formal guidelines or process for update messages;
- (c) update messages are generally provided to investors who have expressed interest or are likely to express interest in the offer;
- (d) update messages are generally provided verbally and are not delivered to investors at the same time;
- (e) update messages typically include information about the level of demand for the offer and the likely clearing price. Examples of update messages include: ‘the offer is covered at the top end of the range’ and ‘the offer has received strong support and participation from existing security holders—strong bidding has also been seen from non-holders’;
- (f) several large licensees have policies that set out guidelines for update messages, including:
 - (i) update messages must be fair and not misleading, limited to factual matters and avoid inflammatory language. For example, ‘overwhelming demand’ was not permitted but ‘well covered’, ‘fully covered’ or ‘multiple times covered’ were permitted;
 - (ii) update messages may provide a general description of the investors who are bidding (e.g. ‘strong domestic interest’ or ‘strong support from global long only and hedge funds’) but not provide specific splits;
 - (iii) if a book is partially covered, some licensees allow statements such as ‘the book is one-third covered’, ‘the book is 80% covered in the middle of the range’ or ‘bids lower than a certain price will not receive an allocation’; and
 - (iv) consideration needs to be given to obligations of client confidentiality in providing updates;
- (g) licensees noted a level of caution about providing update messages given the dynamic nature of a bookbuild and ASIC’s focus on this area; and
- (h) licensees have a range of practices when confronted with the situation where a previous message is no longer correct. Most licensees could not clearly articulate how they manage this situation. The policy of one licensee required the ECM team to consider whether a further communication was needed and, depending on the nature of the change, escalate the matter to compliance.

Feedback following allocations

- 175 Following completion of the allocation process, licensees contact investors who have bid for securities to confirm the allocation to be provided to the investor (post-allocation message). At this time, we noted it is common for the licensee to provide feedback to the investor about the nature and level of demand for the offer. For example, the ‘offer was strongly supported by a range of new and existing security holders’ or ‘the issuer wanted to bring some new institutional investors onto the register’.

Messages from issuers

- 176 On completion of an IPO and before listing, issuers are required to make pre-quotations disclosures to the relevant exchange. For listings on the ASX this includes a list of the top 20 security holders and a distribution schedule showing the spread of investors by size of holding.
- Note: Investors are also subject to reporting obligations in relation to substantial security holdings set out in Ch 6C of the Corporations Act.
- 177 For secondary capital raisings, issuers must disclose information (under their continuous disclosure requirements) about transactions to the relevant exchange. There is often commentary about the level and nature of investor demand (e.g. ‘the offer was heavily subscribed with strong support from both existing security holders and new investors’). For IPOs, we observed that it was less common for the issuer to release a market announcement which included a comment about the level and nature of demand for the offer.
- 178 Some institutional investors expressed concern with statements in market announcements about the level and nature of investor demand. They cited examples where offers that were communicated as being ‘heavily oversubscribed’ traded at a discount to the issue price in the after-market. This might suggest that the demand from investors was not as strong as stated in the announcement.
- 179 We were advised that issuers rely on information provided by licensees to support statements about the nature and level of investor demand contained in market announcements.
- 180 Institutional investors also provided feedback that they see the allocation process as a ‘black box’. They understood that for keenly sought after offers it was not possible for all investors to receive their desired allocation, but they suggested they would have greater confidence in the process if there was more transparency about allocation outcomes.

- 181 Institutional investors suggested that transparency of allocations would be improved if market announcements by issuers included:
- (a) the total number of securities allocated to employees and principal accounts of licensees (and their related entities) involved in the transaction (where transactions are oversubscribed); and
 - (b) for secondary capital raisings:
 - (i) details of the split of allocations between new and existing security holders; and
 - (ii) a list of the top 20 allocations, with the names of investors removed.

Better practices for licensees

E1 We expect licensees to:

- (a) have clear processes and responsibilities as to who can provide messages in relation to transactions. This includes the preparation and review of messages to ensure they do not contain misleading or deceptive information;
- (b) send messages to investors at the same time or as close together as practical;
- (c) provide any messages in writing;
- (d) ensure communications by employees of the licensee to investors are consistent with the messages provided by the ECM team;
- (e) have a reasonable basis for any messages that a transaction is 'covered' or 'cornered' (or other similar wording). In determining this, bids from related investment managers, employees and principal accounts, and any bids that the licensee deems excessive (considering their knowledge of the investor), should be excluded;
- (f) provide an update message if previously communicated information is or becomes inaccurate; and
- (g) ensure they are accurate and not misleading or deceptive in any feedback provided in the post-allocation message.

For the purpose of this section, messages include update messages.

Better practices for issuers

E2 When preparing market announcements that comment on the nature and level of demand for a transaction, we expect issuers to:

- (a) ensure these statements are accurate and not misleading—the use of overly expressive language should be avoided; and
- (b) make appropriate inquiries of the licensee to understand the composition of the demand and understand if it includes any inflated or exaggerated bids or bids from related investment managers, employees or principal accounts.

F Allocations to parties connected to the licensee

Key points

This section outlines our findings on the approach licensees adopt in allocations to parties connected to them, including related investment managers, employees and principal accounts.

This is a high-risk area for conflicts of interest and we set out better practices for licensees.

We also set out our findings on how licensees handle transactions introduced by employees outside of the ECM team.

- 182 Allocations to related investment managers and employees and principal accounts raise significant conflicts of interest concerns.
- 183 Licensees are gatekeepers who are paid by issuers to manage transactions. In this role, they obtain information about the overall level of demand for transactions and the interest expressed by investors. They also obtain an indication of the likely after-market demand for an issuer's securities. This places licensees at a significant information advantage compared to investors who bid for securities in transactions.
- 184 Allocations to employees and principal accounts also have the potential to influence decisions of the licensee (e.g. advice to clients and research decisions). This may result in advice being provided that may not be in the best interests of the issuer or the licensee's investing clients.

Allocations to related investment managers

- 185 Some licensees have related entities that manage funds on behalf of third-party investors (for this report we refer to these as 'related investment managers').
- 186 We observed that most large licensees had a process—often reflected in policies and procedures—for managing bids and allocations by related investment managers. This included:
- (a) providing related investment managers and other investors with the same information at the same time;
 - (b) ensuring that bids by related investment managers follow the same process as other institutional investors (e.g. when bids are due);
 - (c) not giving preferential treatment to related investment managers; and

- (d) making sure that allocations to related investment managers are consistent with the issuer's objectives and disclosed to the issuer.

187

In transactions we reviewed, related investment managers typically did not receive an allocation. Where an allocation was made to a related investment manager, we observed that the scale-back applied to these bids was similar to that applied to comparable unrelated investors.

Better practices

- F1** Licensees should have policies and procedures to manage the treatment of bids by related investment managers when making allocation recommendations, including:
- (a) clearly identifying related investment managers;
 - (b) treating related investment managers in the same manner as other investors, for example:
 - (i) ensuring information about the transaction (including the level of demand) is the same as that provided to other investors;
 - (ii) providing information about the offer to both related investment managers and other investors at the same time;
 - (iii) following the same process for bids by related investment managers as for other investors; and
 - (iv) applying scale-backs and allocation recommendations for related investment managers on a similar basis to comparable unrelated investors; and
 - (c) ensuring allocations to related investment managers are disclosed to the issuer and are consistent with the issuer's objectives.

Allocations to employees and principal accounts

188

We observed that licensees who are managing transactions sometimes allocate securities to:

- (a) themselves or related entities (for the purposes of this report we refer to these as 'principal accounts'); or
- (b) directors, employees or contractors of the licensee or their related bodies corporate or immediate family (for the purposes of this report we refer to these as 'employees').

Note 1: Principal accounts include any allocation to a licensee's trading desk to help with market-making or facilitation activities.

Note 2: Market participants should also see the definition of 'principal' in the ASIC Market Integrity Rules (Securities Markets) 2017 (Securities Markets Rules) for further information.

189 Where securities are allocated to employees and principal accounts in an oversubscribed offer, the allocation that would otherwise be provided to other investors, including clients of the licensee, is reduced.

Large licensees

190 In general, large licensees do not allow allocations to employees in transactions they are involved in as they can lead to significant conflicts of interest.

191 Large licensees also advised that allocations to principal accounts are not common and tend to be limited to shortfalls in transactions the licensee is underwriting.

192 We observed that most large licensees have policies and procedures for bids by principal accounts, including:

- (a) providing principal accounts and other investors with the same information at the same time;
- (b) submitting bids from principal accounts before the offer opens (or very early in the process) unless the offer is undersubscribed or the allocation results from an underwriting obligation. Any exceptions to this requirement are subject to internal committee and compliance approval;
- (c) in the case of some licensees, prohibiting amendments to the price and size of principal account bids once submitted. Other licensees allow amendments subject to approval by compliance and the head of the desk;
- (d) placing limits on the size of allocations to principal accounts;
- (e) disclosing bids from principal accounts to the issuer in the transaction documentation and in any allocation recommendation provided to the issuer for approval;
- (f) ensuring that bids from principal accounts do not materially affect the pricing of the offer;
- (g) considering their conflicts of interest obligations in relation to allocations to principal accounts. For example, where a transaction can be allocated to external investors, the licensee should consider the appropriateness of a principal allocation;
- (h) scaling back bids by principal accounts to the same (or a greater) extent as for other unrelated investors; and
- (i) limiting any buffer in size and allocating it to unrelated investors before the securities commence or recommence trading.

Note: Also see [Report 452](#) *Review of high-frequency trading and dark liquidity* (REP 452) for ASIC guidance on managing order flow and conflicts of interest when engaging in principal trading and facilitation activities.

Mid-sized licensees

- 193 At mid-sized licensees, allocations to employees occurred in most transactions we reviewed but allocations to principal accounts were less common.
- 194 Most institutional investors did not believe employees should receive allocations given the information that licensees receive about the nature and level of demand for a transaction. Other institutional investors did not believe that allocations to staff accounts presented a conflict, provided they were adequately disclosed, limited in size and subject to appropriate internal controls.
- 195 Our review found:
- (a) licensees advised that allocations to employees:
 - (i) help an issuer undertaking an IPO to meet the spread requirements of the relevant exchange;

Note: Issuers and licensees should be aware that the spread requirement in ASX Listing Rule 1.1, condition 8 'is not met if spread is obtained by artificial means': see ASX Guidance Note 1 *Applying for Admission – ASX Listings* at Section 3.8 'Minimum spread'.
 - (ii) make up the balance if an offer is undersubscribed; and
 - (iii) give retail investors and HNW investors comfort knowing that their adviser has 'skin in the game';
 - (b) there was limited disclosure to the issuer about allocations to employees. Some licensees include general wording in terms of engagement that employees may receive an allocation. We found it was more common for allocations to employees to be aggregated with retail investors and HNW investors;
 - (c) in some instances, licensees had not correctly designated accounts as employee accounts;
 - (d) the ECM team preparing the allocation recommendation sometimes included an allocation of securities for themselves;
 - (e) not all mid-sized licensees had policies and procedures for allocations to employees. Those that did provided that:
 - (i) bids from employees would be excluded when there was excess demand from client bids. In our transaction review we did not see this occur despite some offers being multiple times oversubscribed;
 - (ii) dollar caps would be imposed on allocations to employees where an offer was oversubscribed;
 - (iii) employee bids would be scaled back by at least the same amount as client bids. Nonetheless, we observed a placement where

employees were scaled back by less than bids from HNW investor clients of a licensee;

- (iv) a small buffer may be retained to manage errors or omissions. We observed that this was allocated to investors, or in a few instances to the licensee's ECM team or to the adviser who introduced the transaction to the licensee;
- (v) bids by employees had an internal approval process (e.g. compliance or the CEO);
- (vi) bids from employees were submitted to the ECM team before the commencement of the bookbuild for the transaction; and
- (vii) there were a range of practices for holding periods for allocations to employees, including no holding period through to 28 days.

Better practices for licensees

F2 Allocation recommendations to employees and principal accounts present a significant risk of conflict with the interests of both the issuer and the licensee's investing clients.

It is better practice to avoid this conflict except where an offer is undersubscribed and the allocation is limited to the extent necessary for the issuer to raise the funds sought.

Note: Also see the better practices outlined in F1 and E1 in relation to messages to investors.

Licensees that propose an allocation to employees and principal accounts need robust policies and procedures to manage conflicts, including consideration of:

- (a) its appropriateness, bearing in mind the level and quality of demand received from investors for the offer;

Note: For example, imposing caps on the number of securities that can be allocated to employees and principal accounts or excluding these allocations entirely.

- (b) disclosure to the issuer of any allocation proposed to employees and principal accounts;

Note: For example, separately listing the total number of securities to be allocated to employees and principal accounts in the allocation recommendation provided to the issuer for approval.

- (c) other than where an offer is undersubscribed, disclosure by licensees to investors who received an allocation of any allocation made to employees and principal accounts;

Note: For example, when advising clients of their allocation, provide details of the total number of securities allocated to employees and principal accounts.

- (d) the timing and process for submitting bids by employees and principal accounts to the ECM team. It is better practice to submit

these bids early in the process and, at a minimum, before the commencement of the bookbuild for the transaction;

- (e) appropriate minimum holding periods for any securities allocated to employees and principal accounts (e.g. at least several weeks);
- (f) internal approval processes for bids by and allocation recommendations to employees and principal accounts;
- (g) monitoring and review arrangements, including enforcement of minimum holding periods; and
- (h) treatment of any buffer—it is better practice to allocate these securities to unrelated investors before the issuer's securities recommence trading.

Licensees should ensure that employees and principal accounts are correctly designated as such.

Transactions introduced by public-side employees

- 196 We observed at times that employees from the public (or trading) side of a licensee may introduce a potential transaction to the licensee. Where this occurs, the more common approach is for the employee to refer the opportunity to the licensee's ECM team who market the transaction through their usual distribution channels (ECM managed).
- 197 A less common approach is where the employee from the public side of the licensee leads the transaction. This may include advising the issuer on pricing and terms and managing allocations with limited input from the licensee's ECM team (advisor managed).
- 198 We observed an advisor-managed transaction where:
- (a) an employee from the public side of the licensee managed the transaction and allocated a large number of securities to himself and to his related entities;
 - (b) the licensee did not correctly designate the employee's trading accounts as employee accounts;
 - (c) the transaction was not marketed through the licensee's usual distribution channels, but was limited to a smaller number of investors skewed to clients of the employee managing the transaction; and
 - (d) the employee collected around 90% of the fees generated by the licensee for the transaction.
- 199 We have concerns with the advisor-managed model given the inherent risk of mishandling inside information and mismanaging conflicts.

Better practices for licensees

- F3** Where an employee on the public side of the licensee identifies or becomes aware of a potential transaction, it is better practice for these opportunities to be passed to the licensee's ECM team to manage.

Note: The ECM team may decide at a later stage to wall-cross the employee who introduced the transaction to help with distribution of the offer.

Licensees should have effective arrangements (managed by compliance or another control function) for wall-crossing staff who come into possession of inside information.

We encourage firms to review their remuneration structures to ensure they do not incentivise public-side employees to seek out or discuss corporate advisory matters involving inside information with listed companies.

Appendix 1: International regulatory approaches

Background

200 Australia operates under a principles-based approach to financial services regulation: see [ASIC's Statement of Intent 2018](#). Examples of this include the obligation for AFS licensees to manage conflicts and provide financial services efficiently, honestly and fairly: s912A of the Corporations Act.

201 The principles-based approach is supplemented, where appropriate, by regulatory guidance. This guidance explains how we interpret the law, describes the principles underlying our approach, and provides practical guidance to the regulated population.

International Organization of Securities Commissions

202 In September 2018, IOSCO published guidance addressing the potential conflicts of interest and associated conduct risks in the equity capital raising process: see IOSCO's report, [Conflicts of interest and associated conduct risks during the equity capital raising process](#) (PDF 353 KB).

203 The guidance details the key stages of transactions where the role of financial intermediaries might give rise to conflicts of interest that compromise the integrity and efficiency of the process. The guidance comprises eight measures that address:

- (a) conflicts of interest and pressure on analysts during the formation of their views on an issuer in the pre-offering phase of a capital raising;
- (b) conflicts of interest during the allocation of securities;
- (c) conflicts of interest and conduct risks in the pricing of securities offerings; and
- (d) conflicts of interest and conduct risks stemming from personal transactions by staff employed within firms managing a securities offering.

204 The guidance is the first stage of IOSCO's work in examining conflicts of interest and associated conduct risks in the capital raising process. The second phase will consider conflicts of interest and associated conduct risks during the debt capital raising process.

United States

205 The Financial Industry Regulatory Authority (FINRA) rules are designed to promote transparency and establish conduct standards in the capital raising process.

Note: Every firm and broker that sells securities to the public in the United States must be licensed and registered by FINRA.

- 206 [FINRA Rule 5130](#) (Restrictions on the purchase and sale of initial public equity offerings) prohibits restricted persons (e.g. broker-dealers and their immediate family members) from participating in new issues of securities (subject to a limited number of exceptions).
- 207 [FINRA Rule 5131](#) (New issue allocations and distributions) is intended to support public confidence in the IPO process by establishing requirements with respect to the allocation, pricing and trading of new issues by member firms. The rule is subject to specified exceptions.
- 208 Rule 5131 prohibits:
- (a) *quid pro quo allocations*—using the IPO allocation process to receive excessive compensation for services provided;
 - (b) *spinning*—allocating IPO shares to any account in which an executive officer, director and certain former or prospective investment banking client or a person materially supported by such executive officer or director, has a beneficial interest. Firms are required to establish, maintain and enforce policies and procedures that are reasonably designed to prevent investment banking personnel from indirectly or directly influencing or being involved in their firm’s new issue allocation decisions;
 - (c) *levying penalties on flipping*—firms trying to recoup a portion of the commission paid from investment advisers whose clients sell IPO shares they were allocated soon after listing (unless the managing underwriter has assessed a penalty bid on the entire syndicate); and
 - (d) *acceptance of market orders*—members soliciting or accepting market orders for the purchase of IPO shares in the secondary market before the start of trading.
- 209 Distribution participants also need to comply with Rule 101 of the Securities and Exchange Commission (SEC)’s Regulation M under the *Securities Exchange Act 1934*. This rule focuses on securities distributions and, with some exceptions, prohibits distribution participants from engaging in certain trading activities that could artificially raise the price of a security or create a false appearance of active trading in the market, including:
- (a) soliciting from clients their intention to place an after-market order and the quantity of the order before the completion of the securities distribution;
 - (b) telling clients that purchasing shares in the after-market would help them obtain an allocation in other popular IPOs;
 - (c) encouraging investors that have indicated an interest in after-market purchases to increase the price they would be willing to pay because other customers have provided higher after-market price limits; and

- (d) rewarding clients for placing after-market orders by allocating additional IPO shares to them.

210 As part the FINRA360 review, FINRA released a [progress report](#) advising that it was preparing to file amendments to FINRA Rule 5130 and Rule 5131 with the SEC. The amendments would remove a range of impediments to capital formation that it considered to be unnecessary to protect investors. The proposed amendments would also exempt additional persons and types of transactions from the scope of the rules, modify current exemptions to enhance regulatory consistency and address unintended operational issues: see [Progress report on FINRA360](#) (PDF 398 KB), April 2018.

United Kingdom

- 211 The Financial Conduct Authority (FCA) has published the [Conduct of Business Sourcebook](#). Chapter 11A.1 sets out rules and guidance for underwriting and placing applicable to Markets in Financial Instruments Directive (MiFID) or equivalent third country business (in the European Union), including references to Articles 38–43 of the MiFID II Delegated Regulations: see section on ESMA (paragraphs 215–217).
- 212 In October 2016, the FCA published the findings of a review of the factors that influence IPO allocations to investors: see FCA, [Quid pro quo? What factors influence IPO allocations to investors?](#) (PDF 2.72 MB), Occasional paper 15. The review sought to understand if the IPO allocation process works in the interest of issuers or whether conflicts of interest may result in investment banks favouring their highest-revenue clients when deciding on final allocations in IPOs.
- 213 Key findings were:
- (a) syndicate banks make favourable allocations to investors who provide them with information likely to be useful in pricing the IPO, particularly investors who submit price-sensitive bids and those who attend meetings with the issuer before the IPO;
 - (b) book-runners made favourable allocations to investors from whom they generate the greatest revenues elsewhere in their business, notably through brokerage commissions;
 - (c) long-only investors seem to receive more favourable allocations than hedge funds; and
 - (d) there was no evidence that banks make less favourable allocations to investors who go on to sell those shares shortly after the IPO, or that they favour investors who provide after-market liquidity.
- 214 The FCA also found there is no unique optimal allocation or pricing policy for each IPO, and so it is difficult to quantify the extent, if any, to which

allocating shares to banks' preferred clients leads to a less favourable outcome for issuers.

European Securities and Markets Authority (ESMA)

- 215 [MiFID II](#) came into effect on 3 January 2018. Provisions relevant to allocations are generally addressed through the conflicts of interest regulations—in particular, Articles 38 to 43 of the MiFID II Delegated Regulation.
- 216 Key requirements for firms that provide underwriting or placing of financial instruments include:
- (a) providing specified information to issuers before accepting a mandate to manage an offering, including the timing and process for the offer and details of targeted investors;
 - (b) identifying all underwriting and placing operations provided by the firm, and ensuring that adequate controls are in place to manage any potential conflicts of interest;
 - (c) implementing and maintaining effective arrangements to prevent recommendations on placing from being inappropriately influenced by any existing or future relationships (e.g. laddering and spinning);
 - (d) establishing, implementing and maintaining effective internal arrangements to prevent or manage conflicts of interests that arise where persons responsible for providing services to the firm's investment clients are directly involved in decisions about recommendations to the issuer client on allocations; and
 - (e) setting out record-keeping requirements in relation to an underwriting or placing.
- 217 On 3 October 2018, ESMA released [Questions and answers on MiFID II and MiFIR investor protection topics](#). The purpose of this document is to promote common supervisory approaches and practices in the application of MiFID II and MiFIR in relation to investor protection topics. It provides responses to questions posed by the general public, market participants and competent authorities in relation to the practical application of MiFID II and MiFIR. Section 6 includes information about underwriting and placing.

Hong Kong

- 218 The Hong Kong Stock Exchange (HKSE) Main Board Listing Rules permit a new issue of shares to be offered by way of 'placing' unless there is likely to be significant public demand for the securities.
- 219 [Practice Note 18](#) (Initial public offer of securities) sets out certain procedures to be adopted in the allocation of shares in IPOs. It also sets out certain

procedures to be adopted where an IPO involves a placing tranche and public subscription tranche of securities.

- (a) The total number of securities available for public subscription (taking account of any clawback feature in the case of issues which involve both placement and public subscription tranches) are to be divided equally into pools: pool A and pool B:
 - (i) Pool A—securities in pool A should be allocated on an equitable basis to applicants who have applied for securities in the value of HK\$5 million or less.
 - (ii) Pool B—securities in pool B should be allocated on an equitable basis to applicants who have applied for securities in the value of more than HK\$5 million and up to the value of pool B.
- (b) Where one of the pools is undersubscribed, the surplus securities should be transferred to satisfy excess demand in the other pool and be allocated accordingly.

220 No applications should be accepted from investors applying for more than the total number of shares originally allocated to each pool. Multiple applications within either pool or between pools should be rejected.

221 Placements are covered by Appendix 6 ‘Placing guidelines for equity securities’ of the Main Board Listing Rules. The key points are:

- (a) the securities to be placed must have an adequate spread of holders, the number depending on the size of the placing, but as a guideline there should be not less than three holders for each HK\$1,000,000 worth of the share issue, with a minimum of 100 holders at the time of listing (paragraph 4 of Appendix 6);
- (b) neither the lead broker nor any distributor may retain any material amount of the securities being placed for their own account; and
- (c) where there is public demand, neither the lead broker nor any distributor may retain more than 5% of their respective shares of the total placing. Where securities are made available by the lead broker direct to the general public by application direct to the lead broker and there is insufficient public demand, the amount not taken up can be redistributed to clients of the lead broker.

Singapore

222 The Singapore Exchange Limited (SGX) maintains a range of rules for allocations in transactions. [Part IX of Chapter 2](#) of the Mainboard Rules includes the following requirements:

- (a) *public subscription tranche*—all IPOs must include a public subscription tranche (being a minimum of 5% or S\$50 million

(whichever is the lower) of the IPO offer size). The following rules apply:

- (i) allocations must be made on a fair and equitable basis;
 - (ii) balloting procedures used to determine how the public subscription tranche is allocated must be clearly spelt out and strictly adhered to; and
 - (iii) any shares not taken up in the public subscription tranche at the close of the offering are reallocated to the placement tranche;
- (b) *capped allocation*—securities allocated or allotted to the issue manager, underwriter, lead broker, distributor or any of their connected parties or discretionary managed portfolios are limited to 25% of the offer. Any securities allocated to these parties must be disclosed before the issue is listed; and

Note: The capped allocation does not apply to allocations to underwriters or sub-underwriters.

- (c) *issuer discretion*—the issuer may reserve up to 10% of the offer for allocation to its employees, directors, customers, suppliers and persons who have contributed to the success of the corporate issuer.

Note: SGX is regulated by the Monetary Authority of Singapore (MAS) in its performance as a frontline regulator and market operator of the securities and derivatives markets. From 18 July 2016, SGX has transferred its regulatory functions to a separate subsidiary company to manage any potential conflict of interest between SGX's commercial and regulatory roles. MAS is the statutory regulator and has oversight over SGX's regulatory responsibilities as performed by its regulatory subsidiary.

Appendix 2: Examples of risk assumed by licensees

Hard underwriting

- 223 For the purposes of this report, we refer to hard underwriting as an agreement between a licensee and an issuer entered before the bookbuild for a transaction commences. The agreement provides that, if investors do not take up securities being offered in the transaction, the licensee will acquire them on a specified date at an agreed price.
- 224 A licensee may seek to manage its underwriting risk by wall-crossing a small number of investors before starting to market the transaction to understand their level of interest in the transaction or to act as sub-underwriters for all or part of the licensee's underwriting exposure.

Settlement underwriting

- 225 For the purposes of this report, we refer to settlement underwriting as an agreement between a licensee and an issuer that makes the licensee responsible for 'underwriting' once allocations for a transaction have been made to investors. The agreement provides that any amounts not paid by investors on the settlement date for the transaction will be paid by the licensee to the issuer.
- 226 For the purposes of Ch 6 of the Corporations Act (regarding takeovers and exceptions to the general prohibition) and Ch 6D of the Corporations Act (regarding disclosure for offers of securities), 'settlement underwriting' is not considered to be 'underwriting': see Section E of RG 6.

Note: [Report 512](#) ASIC regulation of corporate finance: July to December 2016 (REP 512) made some observations about termination rights in underwriting agreements. For example, it noted that where an offer is described as 'underwritten', investors will ordinarily expect that the underwriter is in fact assuming a real shortfall risk and may decide to commit funds to the offer on this basis. Where this is not the case, describing the offer as 'underwritten' may be misleading: see the note to paragraph 138 of RG 6.

Appendix 3: Summary of relevant legislative provisions

Table 3: Summary of relevant provisions of the Corporations Act

AFS licensee obligations (s912A)	<p>An AFS licensee must:</p> <ul style="list-style-type: none"> do all things necessary to ensure their financial services are provided efficiently, honestly and fairly; comply with financial services laws and take reasonable steps to ensure their representatives do likewise; have adequate compliance arrangements; have adequate arrangements for the management of conflicts that may arise wholly, or partially, in relation to the provision of financial services; and have adequate resources, be competent, and ensure that representatives are adequately trained and supervised.
Prohibition against market manipulation (s1041A)	A person must not engage in a transaction that has or is likely to have the effect of creating an artificial price for trading in financial products or maintaining a price that is artificial.
Prohibition against misleading or deceptive conduct (s1041H)	A person must not engage in conduct in relation to a financial product or a financial service that is misleading or deceptive or is likely to mislead or deceive.
Prohibition against insider trading (s1043A)	<p>An insider who possesses inside information, and knows or should reasonably know that the information they possess is insider information, must not:</p> <ul style="list-style-type: none"> apply for, acquire or dispose of the relevant entity's financial products (or enter into an agreement or procure another person to apply for, acquire or dispose of the relevant entity's financial products); or directly or indirectly communicate the information to another person if the insider knows or should reasonably know that the other person would acquire or dispose of (or apply for or enter into an agreement to acquire or dispose of) the relevant entity's financial products or procure another person to do so.
Exceptions to the prohibition against insider trading (s1043B–K)	Exceptions to the prohibitions against insider trading.

Table 4: Summary of relevant provisions of the ASIC Act

Misleading or deceptive conduct (s12DA)	A person must not engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive.
False or misleading representations (s12DB)	A person must not make a false or misleading representation in connection with the supply of financial services or in connection with the promotion of the supply or use of financial services.

Key terms

Term	Meaning in this document
1D VWAP	Volume weighted average price for one day of trading on a relevant exchange
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee or licensee	A person who holds an Australian financial services licence under s913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.
allocation recommendation	A recommendation provided by a licensee to an issuer setting out the proposed allocation of new securities
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
ASX	ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited
auction process	Where a licensee seeks bids for new securities from investors at different prices steps, often within a range The auction process seeks to determine the highest price for which there is demand from investors for the amount sought to be raised in a transaction
block trade	An off-market trading mechanism enabling orders of significant size to be arranged and transacted without pre-trade transparency (see Chapter 6 of the Securities Markets Rules)
bookbuild	The process of generating, recording and capturing demand from potential investors who express interest in an allocation in a transaction
cash market products	As defined in Rule 1.4.3 of the Securities Markets Rules
[CO 09/425] (for example)	An ASIC class order (in this example numbered 09/425)

Term	Meaning in this document
conflicts of interest	Circumstances where some or all of the interests of clients to whom an AFS licensee (or its representative) provides financial services are inconsistent with, or diverge from, some or all of the interests of the AFS licensee or its representatives. This includes actual, apparent and potential conflicts of interest
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
DRP or dividend reinvestment plan	A process by which a company offers a security holder the ability to increase their holding in a company by electing to take some or all of the available dividends in the form of the issue of further securities in the company
eligible jurisdiction	A jurisdiction in which the issue of new securities may be lawfully made to investors
eligible security holder	An existing security holder who is eligible to participate in a transaction
employee	Employee, in relation to a licensee, includes a director, employee, officer, agent, representative, consultant or adviser of that licensee, or an independent contractor who acts for or by arrangement with a licensee
ECM team	Employees at a licensee who are permanently wall-crossed and sit within the private (i.e. non-public) side of the licensee, including investment banking, corporate finance, equity capital markets or equity syndication
experienced investor	Has the meaning given in s708(10) of the Corporations Act
hedge fund	A registered managed investment scheme that is promoted as a hedge fund or exhibits two or more of the characteristics of a hedge fund: see Regulatory Guide 240 <i>Hedge funds: Improving disclosure</i> (RG 240)
HNW (high net worth) investors	A sophisticated, experienced or professional investor who is not an institutional investor
inside information	Has the meaning given in s1042A of the Corporations Act
insider trading	Conduct prohibited under s1043A of the Corporations Act which includes a person who is in possession of inside information (the insider): <ul style="list-style-type: none"> • acquiring or disposing of securities or procuring another person to do so; and • communicating the inside information to another person if the insider knows, or ought reasonably to know, that the other person would be likely to acquire or dispose of securities or would procure another person to do so

Term	Meaning in this document
institutional investor	Entities in the business of investing in securities, including investment banks, hedge funds, insurance companies, sovereign wealth funds, AFS licensees or equivalent overseas licence holders
investor education reports	Reports prepared by a licensee mandated to advise on a capital raising transaction (usually an IPO) and released before a prospectus is lodged with ASIC
IPO	Initial public offering
issuer	Listed entities, or entities seeking to list on an exchange, who are seeking to raise equity capital
JLM	Joint lead manager
market participant	A participant within the meaning of s761A of the Corporations Act, in relation to a financial market
placement	A capital raising by a listed company under s708 of the Corporations Act
principal account	An account in the name of the licensee or its related entities Market participants should also see the definition of 'principal' in the Securities Markets Rules for further information
private-side employee	An employee who works on the private side of a licensee—that is, they are permanently wall-crossed and sit behind a 'Chinese' wall. It also includes any employee from the public side of the licensee who may receive inside information which requires them to be wall-crossed and sit on the private side of the licensee until the inside information has become generally available
professional investor	Has the meaning given in s708(11) of the Corporations Act. In general terms, this is an investor who has, or controls, gross assets of at least \$10 million
prospectus	A prospectus that is lodged with ASIC under s718 of the Corporations Act
public-side employee	An employee who works on the public side of a licensee (i.e. not a private-side employee), for example an employee who works on the sales or trading desk
related body corporate	Has the meaning given in s50 of the Corporations Act
related entities	Has the meaning given in s9 of the Corporations Act
related investment managers	Related entities of a licensee that manage funds on behalf of third-party investors

Term	Meaning in this document
REP 486 (for example)	An ASIC report (in this example numbered 486)
retail investor	An investor who does not qualify as a professional, experienced or institutional investor—that is, a person who invests for their own personal account rather than on behalf of other investors or entities. Retail investors in this report may include self-managed superannuation fund investors and HNW investors (who would qualify as sophisticated investors)
RG 264 (for example)	An ASIC regulatory guide (in this example numbered 264)
s912A (for example)	A section of the Corporations Act (in this example numbered 912A), unless otherwise specified
S&P/ASX 200	The index known as the S&P/ASX 200
S&P/ASX 300	The index known as the S&P/ASX 300
securities	Has the meaning given in s92 of the Corporations Act
Securities Markets Rules	ASIC Market Integrity Rules (Securities Markets) 2017—rules made by ASIC under s798G of the Corporations Act
sophisticated investor	Has the meaning given in s708(8) and 708(10) of the Corporations Act. In general terms, this includes an investor: <ul style="list-style-type: none"> • who has net assets of at least \$2.5 million, or gross income of at least \$250,000 for each of the past two financial years; or • about whom an AFS licensee is satisfied that the person has sufficient previous experience in investing in securities
SPP	Security purchase plan
sub-underwriter	A party that evaluates and assumes some or all of an underwriter's risk
terms of engagement	The terms of the licensee's engagement by the issuer usually set out in a document which may be referred to as a mandate letter, underwriting agreement or offer management agreement
transaction	An equity raising by an issuer who is seeking to raise funds from investors through the issue of new securities
underwriter	A party that evaluates and assumes another party's risk, typically for a fee
underwriting	The act of accepting a specific transaction's risk as an underwriter
VWAP	Volume weighted average price
wall-crossed	When a person receives inside information and agrees not to use the information until it is generally available

Related information

Headnotes

advisers, allocations, bookbuild, capital raisings, conflicts of interest, dividend reinvestment plans, employees, entitlement offer, information barriers, initial public offerings, inside information, insider trading, IPOs, joint lead manager, listed entities, non-renounceable, placements, principal trading, pro rata, renounceable, secondary capital raisings, security purchase plans, soundings, wall-crossing

Regulatory guides

[RG 6](#) *Takeovers: Exceptions to the general prohibition*

[RG 104](#) *Licensing: Meeting the general obligations*

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

[RG 240](#) *Hedge funds: Improving disclosure*

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

Legislation

ASIC Act, Pt 2; s12DA and 12DB

Corporations Act, Pt 7.10; s124, 180, 181, 184, 674, 710, 734, 912A, 1041A, 1041H, 1042A, 1043A and 1043B–1043K

Reports

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

[REP 486](#) *Sell-side research and corporate advisory: Confidential information and conflicts*

[REP 512](#) *ASIC regulation of corporate finance: July to December 2016*

[REP 540](#) *Investors in initial public offerings*

Consultation papers

[CP 46](#) *Licensing: Managing conflicts of interest*

[CP 128](#) *Handling confidential information*

[CP 290](#) *Sell-side research*