



# ASIC review of IPOs – Key Lessons

October 2016

The Australian Securities and Investment Commission (ASIC) has recently reviewed and reported on matters of concern regarding 'due diligence' and 'marketing practices' in initial public offerings (IPOs). In this Capital Markets update we highlight ASIC's key findings and recommendations in its recent [Due Diligence Report](#) and [Marketing Practices Report](#).

Due Diligence Practices	
Poor due diligence leads to defective disclosure	<ul style="list-style-type: none"> <li>Issuers that demonstrated poor due diligence practices generally produced prospectuses with defective disclosure (e.g. misleading and deceptive statements with no reasonable basis) and omitted material information that would have been included had the issuer conducted reasonable investigations.</li> </ul>
'Form over substance' approach to due diligence	<ul style="list-style-type: none"> <li>Even in instances where a number of due diligence processes had been adopted and followed, a number of issuers adopted a 'box ticking' approach to the due diligence.</li> </ul>
Costs of conducting due diligence	<ul style="list-style-type: none"> <li>While it may appear cost effective to engage a less costly adviser with a checklist approach to conducting due diligence, ASIC found that a well-advised issuer conducting the necessary due diligence processes will be better placed to mitigate the risk of any added delays (and related costs), future liability and reputational damage from a poor-quality prospectus.</li> </ul>
Superficial involvement by the board of directors	<ul style="list-style-type: none"> <li>Even though the directors of an issuer have direct liability under the Corporations Act, ASIC found that some directors had little involvement in the preparation of the prospectus before signing off on the document. ASIC also observed that in certain instances prospectuses and other important documents were not translated for directors who cannot read English.</li> </ul>
Variation in due diligence processes adopted	<ul style="list-style-type: none"> <li>Generally, small to mid-sized issuers adopted fewer due diligence processes (e.g. convening a due diligence committee but nothing more) and demonstrated less effort in and consideration of the process.</li> </ul>

## Marketing Practices

<b>Misleading communication</b>	<p>ASIC expressed concerns regarding:</p> <ul style="list-style-type: none"> <li>• marketing of IPOs other than on its merits;</li> <li>• prominence of forecasts; and</li> <li>• marketing of emerging market issuers.</li> </ul>
<b>Inadequate controls on access to information</b>	<ul style="list-style-type: none"> <li>• Access arrangements for roadshows held before a prospectus was lodged with ASIC were not always limited to Australian financial services (AFS) licensees and their representatives.</li> <li>• Sometimes access to pathfinder prospectuses on websites were not carefully restricted to sophisticated or professional investors.</li> <li>• Firms and issuers did not always properly control access to information about the offer to ensure retail investors base their decision on the prospectus.</li> <li>• Some firms and issuers may be disseminating information to the media before the prospectus is lodged with ASIC in a way that undermines the advertising provisions in the Corporations Act.</li> </ul>
<b>Oversight weakness</b>	<ul style="list-style-type: none"> <li>• There were some oversight weaknesses in relation to marketing conducted via telephone calls and social media. For example, firms' employees did not generally use a script or keep notes of the call.</li> </ul>
<b>Failure to monitor</b>	<ul style="list-style-type: none"> <li>• Firms and issuers failed to update multimedia marketing including videos (e.g. to ensure the content of any videos remains correct after changes or updates are made to a prospectus)</li> </ul>

ASIC has provided the following recommendations (among others) for firms and issuers to address the above problems.

## Due diligence practices

- **Elements of a robust due diligence process** - Issuers should adopt a due diligence process that promotes:
  - oversight of the due diligence process (e.g. by the due diligence committee and board);
  - investigations into the information in the prospectus (e.g. management interviews, director questionnaires and specific legal, tax and other investigations);
  - record keeping of the key or significant issues and their resolution;
  - verification of all material statements of fact or opinion in the prospectus; and
  - continuation of the due diligence process after the lodgement of the prospectus and throughout the offer period to capture material developments, including regular meetings of the due diligence committee and ensuring that any new material matters that arise are addressed by the committee and board.
- **Director involvement** - Directors must make sure that a robust due diligence process has been undertaken, including having a robust dialogue with management and expert advisers involved in the due diligence and participating in the verification process.
- **A 'substance over form' approach** - The documentation of the due diligence and verification process should demonstrate that a reasonable due diligence investigation has been conducted. For example, due diligence committee meeting minutes might demonstrate that there was a robust discussion of material issues rather than merely acknowledging them.
- **Engaging expert advisers** - An effective due diligence process should identify the material matters that will require an expert opinion and ensure that the appropriate advisers are engaged (e.g. a legal opinion to confirm the validity of an issuer's assets).
- **Emerging market issuers** - Australian advisers should focus on effective oversight of the due diligence work carried out by foreign legal and other advisers. Australian advisers should make sure that they understand the political and cultural environment in which the issuer operates, local business practices and local laws affecting the issuer.

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## Marketing practices

- **Forecasts** - Firms and issuers should not give undue weight to forecasts in the marketing messages and, if forecasts are used, ensure the assumptions and risks of the forecasts are also included in the marketing material.
- **Marketing** - Firms should ensure that marketing is based on the merits of the IPO itself and not based primarily on other successful IPOs conducted by the firm.
- **Pathfinder Prospectuses** - Firms should apply tighter controls and educate their employees to limit access to restricted material (including pathfinder prospectuses) to sophisticated or professional investors and ensure that passwords to access restricted material are not distributed by email.
- **Roadshows** - Firms should apply tighter controls and educate their employees to limit access to institutional roadshows to AFS licensees and their representatives.
- **Non-English speaking investors** - If marketing material is being produced in a language other than English, ensure these materials are fully understood by the firm or issuer, including getting translations before publication.
- **Verify sophisticated and professional investors** - If marketing is given to persons before a prospectus is lodged with ASIC, on the basis of those persons being a sophisticated or professional investor, firms and issuers should ensure that the recipient actually falls within this category (e.g. obtain an accountant's certificate). Self-certification by a person is not sufficient.
- **Social Media** - Firms should ensure that social media posts are reviewed before being posted and educate employees on using social media for marketing IPOs in compliance with the Corporations Act.
- **Telephone** - Firms should apply tighter controls over the marketing and selling of IPOs by phone, such as:
  - providing employees with standardised phone scripts;
  - recording and routinely reviewing phone calls with clients;
  - applying stricter requirements on documenting phone calls with clients; and
  - monitor calls more closely (e.g. have a staff member routinely sit at the sales desk when telephone calls are made to clients).



## Where to from here?

ASIC regularly and rigorously reviews prospectuses to ensure their compliance with the Corporations Act and may ask the Issuer to demonstrate their due diligence processes. Further, ASIC has stated that it intends to conduct wider ranging systematic reviews of due diligence practices in the future.

Over the past year, ASIC has intervened on a number of occasions to address misleading statements in IPO marketing. ASIC has stated it will continue to do further work to review the IPO process during this financial year.

Issuers and firms should be warned that ASIC is scrutinising IPOs closely. Not only should you ensure that your due diligence process and marketing practices meet the requirements of the Corporations Act but they should also comply with ASIC's guidance given in its recent reports.



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