



17 March 2021

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Sydney NSW

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Dear Ms Aldridge

ASIC Report 668 Allocations in debt capital market transactions

The members of Australian Financial Markets Association (**AFMA**) have given careful consideration to the better practices provided in ASIC Report 668: *Allocations in debt capital market transactions (Report 668)*. We welcome ASIC's initiative in conducting the review and providing further guidance to the market about debt capital market practices. We think this should help improve standards across the Australian market. Generally, we believe that the better practices in Report 668 align with the policies and procedures of AFMA members.

With that in mind, the AFMA members have the following observations on particular aspects of Report 668. The observations relate to matters concerning the role of compliance, joint lead manager (JLM) orders and inflated bids.

1. Role of Compliance

AFMA members echo comments made in connection with ASIC Report 605: *Allocations in equity raising transactions (Report 605)* and note that Report 668 cross refers to section C2 of Report 605 for better practices on the role of Compliance. In comments made in Report 605, AFMA members made the point that it should be the responsibility of operational management, such as members of the syndicate and capital markets teams, to ensure that allocations adhere to legal, regulatory and policy requirements and that any bookbuild messaging they are releasing is accurate and based on reasonable grounds.

The drafting of Report 668 raises concerns that ASIC is looking to shift more of the responsibility across to Compliance for ensuring that syndicate and capital markets teams adhere to legal and regulatory requirements. This concern is evident, for example, in the proposition that a licensee should “ensure that the

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licensee's compliance and supervision functions are actively monitoring pre-offer engagement" and that post transaction rather than "real time" monitoring can create issues at the time of greatest risk. This suggests that ASIC expects the primary responsibility should rest with Compliance, as opposed to the syndicate and capital markets teams.

We do not believe that such an outcome is consistent with the "*three lines of defence*" risk management model that is generally considered good practice. In addition, requiring Compliance or an equivalent function to review messaging and allocations in real time, would have the effect of shifting responsibility to Compliance functions and away from first line practitioners who are experienced and trained in such activities. While Compliance (or an equivalent review function) has a meaningful and important role to play in support, it is the first-line or front-line syndication managers who are charged with ownership and management of the bookbuild process as well as ensuring compliance with regulatory requirements and management of business conduct risk.

There should be no suggestion that Compliance is part of business activities. Compliance is responsible for reviewing and challenging the frameworks, processes and controls put in place by the business to ensure compliance. In addition, Compliance primarily conduct post-transaction monitoring to ensure the business are discharging their regulatory obligations and complying with internal policies.

Separately, in extending the suggestion that real-time monitoring should occur with respect to pre-offer activity, ASIC is increasing the burden for Compliance resourcing. Pre-offer activities that are not in the nature of market soundings are often not easily identifiable for the purpose of real-time surveillance. Again, it should be for the business owners to be primarily responsible for managing this risk.

2. JLM Interest

The guidance in Report 668 recommends that JLM trading bids are characterised as "JLM interest" even in circumstances where recommendations of allocations to parties connected to the licensee are in the issuer's interests and not their own. AFMA accepts the proposition that investors often express an interest in knowing the proportion of debt securities held by JLM trading desks, as this can form part of the decision-making process around their potential participation in a transaction. To meet this need, the AUD market now includes text to the effect of "*including A\$[XX]mm JLM interest*" in bookbuild messages where there is JLM trading interest in the transaction. However, AFMA members believe that precisely what demand falls within the concept of JLM interest should have regard to how conflicts are managed at the relevant financial intermediary in question.

The definition of a "JLM order" has helpfully been clarified to the market by ASIC in Report 668, noting this includes any JLM trading interest, but excludes balance sheet interest. AFMA members believe that JLM trading desks which are behind

robust information barriers should be treated no differently from any other arms' length investor. AFMA is concerned that a requirement to disclose orders from arms' length JLM trading desks but not to require such disclosure from other arms' length investors could lead to unequal investor treatment.

Furthermore, AFMA notes ASIC's expectation that issuers and investors are notified that parties connected to the licensee are likely to bid and may receive allocations. AFMA's view is that such a requirement as it relates to investors should be unnecessary (or considered satisfied) given the quantum of JLM interest is now disclosed to the market in any update of order book demand. With respect to issuers, such transparency will exist in any event given their access to the book.

AFMA also notes ASIC's requirement that, in oversubscribed issues, licensees should ensure priority is given to investors' interests where there is a conflict with "JLM interest" and allocation recommendations to "JLM interest" are appropriately scaled back or avoided where possible. AFMA notes that market practice is to treat trading desks consistently in terms of allocations, irrespective of whether the bid is from a JLM or not. AFMA members submit that, as long as the issuer has transparency surrounding the orders and is able to make a determination about the JLM interest in the book, then any potential or perceived conflict of interest has been appropriately managed.

3. Inflated bids

AFMA notes ASIC's comment on page 9 of Report 668 that licensees should take all reasonable steps to identify inflated bids, including using their knowledge of the bidder's capacity and previous transaction behaviours—and exclude these from the publicised book size is not good practice. A similar observation is made in Report 605. This requirement is not something that AFMA members believe should rest on licensees.

AFMA members believe that the expectation is an unrealistic one. The determination of whether a bid is excessive or not when taken at face value is very difficult. In most cases, there is little reason to question a professional, experienced investor making a bid for securities. To fail to accept a bid in the event that such an investor has provided it gives rise to other risks, such as failing to act in accordance with a client's instruction. Furthermore, information about whether an investor has sufficient funds under management relative to the size of its bid is difficult to ascertain in many cases because many investors have complex structures and use many different entities and vehicles for investing and trading activity and this information may not be publicly available.

AFMA members are of the view that the legal obligations lie with the investor and these are clear. A licensee is not privy to (nor in many cases should be) all of the factors that may drive an investor's bid. While licensees may query a bid from a non-credible source or question an obvious scenario where a bid is open to scrutiny (e.g. if an investor indicates that their real demand is for [x], but put they

request an order of [x] + [y] to be entered into the book to help secure that demand), to unilaterally exclude a bid based on the licensee's own assessment of an investor's motives could conflict with the licensee's obligations owed to investors under the law (as highlighted above).

AFMA members view the obligation of having to take all reasonable steps to identify inflated bids as an overly high threshold given the above context. In AFMA's view it is reasonable for licensees to warn investors against inflated orders and adopt the following actions:

- There should be consistent messaging across JLMs that inflated orders will not be accepted.
- Syndicate desks should communicate to sales desks that orders should not be inflated and that any inflated orders will not be accepted.
- Sales desks should communicate to investors that orders should not be inflated and that any inflated orders will not be accepted.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely



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