

## Corporate Alert April 2011

### ASIC wants more from companies seeking to raise funds

ASIC has released a consultation paper on improving prospectus content – but is it asking too much of companies (and their directors) who wish to raise funds?

On Tuesday 12 April 2011 ASIC released its consultation paper, proposing “improvements in quality of prospectuses”, the documents designed to adequately inform investors about their decision to invest.

ASIC last sought to improve disclosure and provide guidance in 2006 under its draft “Better Prospectus Disclosure” policy statement. Even then ASIC was concerned prospectuses were too long and not tailored to the particular offer and company making the offer – or in the modern parlance “TLDR” (Too Long; Didn’t Read).

The general rules under the *Corporations Act 2001* (Cth) (**Act**) are that a prospectus must:

- contain all information investors and their advisers would reasonably require to make an informed assessment of the offer and the company; and
- be worded and presented in a clear, concise and effective manner.

ASIC has not been prescriptive to date about what to include to meet these requirements, as every offer and every company making an offer is different. It is for the Board to determine what is relevant and how to present that information clearly. Directors must also ensure that prospectuses are not misleading or deceptive, and that there is a reasonable basis for making each statement in the document.

ASIC’s proposed new guidance note is in much the same vein as the current thinking, but there are some new twists to consider.

### Director’s history

Interests of directors must currently be disclosed. ASIC also proposes that prospectuses should include details of criminal convictions, declarations of breach of civil provisions under the Act, disqualifications, and of companies which entered a form of external administration because of insolvency which occurred during or within 12 months of the time the person was an officer. This information is relevant to investors – they should know of matters which go to the adherence to law, financial acumen and commercial track record of those charged with safeguarding and enhancing their investments.

While well-intentioned, obliging this disclosure is likely to be coupled with the relevant directors seeking to justify or explain their individual roles in any failed corporations. Corporate collapses are complex. The content introduced to address this could become as confusing to investors as it may be enlightening.

It could also mean:

- companies may require police and other checks on management to ensure they are able to rely on the “due diligence” defence in the Act when presenting the information;
- directors with an apparent “history” (even if not justified on a thorough examination of the facts) not being hired by public companies needing to issue a prospectus, to avoid negative public sentiment;
- retail investors placing undue weight on this information,

and may involve some Privacy Act issues.

ASIC has requested feedback on whether the information should be limited to being within a specific time frame, such as the last 7 years.

## Affecting competition

ASIC proposes to require companies to disclose their business models and how they will achieve their goals, including “high-level business strategy”. A specific example in the draft Regulatory Guide is “...we plan to vertically integrate by acquiring key supplier X...” The draft notes that more detailed plans should be included if the information is material and the company has a reasonable basis for expecting the plan will be implemented. The Consultation Paper notes that there is no confidentiality carve-out in the disclosure provisions of the Act.

This could have the effect of destroying a commercial strategy, particularly in relation to planned merger and acquisition activity. Companies will need to think through their timing in relation to issuing a prospectus, balancing appearing as an attractive investment, showing their hand at plans, and ensuring they are not misleading or deceptive in describing future plans.

## Less repetition

The Paper focuses on removing repetition. However, being clear, stating things only once and being user-friendly all at once can be a difficult balance to strike. For example, the Paper recommends that risks are stated alongside the relevant benefit that is being espoused. While this sounds helpful, current market practice is to include a risks page. Investors would generally expect this, with all risks listed and highlighted in one location, not scattered throughout the document where benefits may be articulated under different headings.

The alternative is that “general risks” (although the Paper is not a supporter of these either) are included in the ‘risk section’ with cross-references to the various specific risks that are throughout the document – meaning readers will be flicking back and forth to find the related information that has been stated in only one location.

It will be interesting to see if ASIC takes any action regarding documents being too repetitive.

## No photographs or celebrities please

ASIC is of the view that investors spend the most time considering the first few pages of a prospectus, and less time (if any) on the balance. It also holds the view that

photos are distracting, and may result in investors making decisions based on photographs and other marketing or irrelevant information, rather than the investment itself.

The new thinking is that the front of the document should be dedicated to a clear “investment overview” containing key information, and that photos, if any, should be restricted to appearing only after that overview.

In particular, ASIC seeks submissions from the public about whether it should restrict altogether the use of photographs of celebrities in prospectuses.

This is consistent with the goal of keeping prospectuses shorter and on point. It could level the playing field, where smaller-cap businesses are not ignored due to a failure to have glossy, picture-filled prospectuses that catch the eye. However, it denies companies who have built a brand on a face or a name, and have the marketing spend, the opportunity to exploit this. That is the nature of competition.

## Conclusion and lessons

Many of the ideas contemplated by the proposed regulatory guide are nothing new, and of benefit to investors wading through disclosure documents.

### So what can we take from all this?

- ASIC is attempting to give guidance on how to make important information more accessible to retail investors by recognising the limits and natural preferences of readers – documents need to be as short and simple as possible.
- There may be unintended consequences of some aspects of ASIC’s attempt to improve the regime.
- Regulatory Guides represent how ASIC interprets and applies the law, and a material departure from the guidance given may result in ASIC requiring that a supplementary prospectus be lodged. ASIC may post-vet prospectuses, and can issue stop orders if it considers that a prospectus is not worded in a clear, concise and effective manner or is misleading or deceptive (among other reasons).
- Directors need to be aware of the consequences of failing to comply with the Act given the potential penalties – particularly around misleading or deceptive conduct, having a reasonable basis for making statements, and regarding forward-looking statements.

- Depending on fund-raising needs, if your entity is unlisted and the offer can fall within the various exceptions to the disclosure requirement under the Act, maximise this as far as possible (i.e. utilise the small-scale offerings and sophisticated investor exceptions) – it removes the cost of having to prepare a prospectus.
- If you wish to make a submission to ASIC on the Consultation Paper and would like assistance, please contact us.
- If preparing a prospectus, directors must ensure they have a robust due diligence and verification process established.

Thomsons Lawyers will issue a further Alert when the new Regulatory Guide is released following the consultation period.

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