



**ASIC**

Australian Securities & Investments Commission

## REGULATORY GUIDE 61

# Underwriting — application of exemptions

**Chapter 1 — Introductory and general topics**

**Chapter 6 — Acquisition of shares**

**Chapter 7 — Securities**

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*From 5 July 2007, this document may be referred to as Regulatory Guide 61 (RG 61) or Policy Statement 61 (PS 61). Paragraphs in this document may be referred to by their regulatory guide number (e.g. RG 61.1) or their policy statement number (e.g. PS 61.1).*

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## Purpose

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RG 61.1 In this guide the ASC considers:

- (a) the application of s622(3), s621(1)(b)(ii) and s66(3)(b) of the Corporations Law (Law) (the exemptions) to:
  - (i) underwriting; and
  - (ii) sub-sub-underwriting; and
- (b) whether other exemptions contained in Ch 6 and 7 of the Law or the Corporations Regulations (the Regulations) are available for pre-lodgement underwriting (as defined in para 6 below).

## Background

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RG 61.2 Section 9 simply defines “underwrite” to “include sub-underwrite”. The Law does not define “sub-underwrite”. Extrinsic material (including explanatory memoranda to the Law, the *Companies Act 1981* and the *Companies Act 1961*) do not define “underwrite” or interpret its meaning in s66(3)(b) and its predecessors.

RG 61.3 In general, underwriting means assuming a risk. It is not a term of legal art. As used by stockbrokers, it means assuming the risk that the intended investors will not take up all of an offer of securities. An underwriter of an offer of securities agrees to take up any securities not taken up by the intended investors (the shortfall). If the whole offer is taken up by the market, the underwriter takes up none of the securities (as underwriter) (*Australian Investment Trust Ltd v Strand and Pitt Street Properties Ltd* (1931) 31 SR (NSW) 266, reversed [1932] AC 735, in the absence of a provision such as s204).

RG 61.4 Under the form of underwriting traditional in Australia, the underwriter assumes this risk by agreeing to subscribe for, or procure subscriptions for, securities not otherwise subscribed for under a public offer (*In Re Licensed Victuallers’ Mutual Trading Association; Ex parte Audain* (1889) 42 Ch D 1; *Australian Investment Trust* (1931) 31 SR (NSW) 266; [1932] AC 735; *Anemtech Ltd v Eyres Reed McIntosh Ltd* (1986) 10 ACLR 780). As far as the ASC is aware the courts have never had to decide whether the assumption of this risk by any other legal mechanism should be characterised as underwriting. In the ASC’s view, the courts will adopt current market usage as to the meaning of the term.

RG 61.5 One alternative form of underwriting involves the underwriter:

- (a) subscribing for the entire issue; and
- (b) renouncing part or all of its allotment in favour of members of the public who take the securities on the basis of a prospectus.

Only the shortfall is issued to the underwriter — the rest of the securities are issued to applicants at the underwriter's direction. None of the shares are issued until after the offers close.

RG 61.6 Another alternative form of underwriting involves the underwriter:

- (a) contracting with the issuer to subscribe for, or purchase, all of the securities to be issued or offered for sale by prospectus;
- (b) acquiring the shares *before* the prospectus is lodged; and
- (c) on-selling the shares to persons who apply under the prospectus, (pre-lodgement underwriting).

RG 61.7 References in the Law to underwriting should be understood as including all three forms of underwriting mentioned above, without excluding other possible forms of underwriting.

Pre-lodgement underwriting differs from other forms of underwriting (including those discussed above) in that the acquisition of shares by the underwriter occurs *before* the prospectus is lodged and circulated to the public and not *after*.

RG 61.8 In a pre-lodgement underwriting the order of events may make it difficult or impossible to take advantage of some of the exemptions which relate to underwriting. Paragraphs 17, 19 and 21 of this guide relate to these timing issues.

RG 61.9 It is the ASC's view that an underwriting agreement is a "relevant agreement" as defined in s9 of the Law.

## **“Taking firm” and “market making”**

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### **Taking firm**

RG 61.10 Taking firm (or “underwriting firm”) can mean an agreement under which a person agrees to subscribe for a specific number of shares that are the subject of a public issue, which the person does not intend to on-sell. The agreement holds whether or not the issue is fully subscribed. This activity:

- (a) is not underwriting; and
- (b) does not attract the operation of the exemptions.

RG 61.11 An agreement to subscribe for a specific number of shares which is subject to a provision that the issuer (or the underwriter in the case of an agreement between an underwriter and a sub-underwriter) can recall the shares to satisfy the public demand, is not “taking firm”. If some of the shares are not subject to recall, they have been taken firm and those shares are not offered or acquired under an underwriting agreement.

RG 61.12 In so far as an agreement involves an intermediary agreeing to assume the risk of the shortfall, any shares taken by the intermediary as part of the shortfall are taken under an underwriting agreement. However, to the extent that the same agreement involves the intermediary taking firm from the outset, any shares so taken will not be taken under an underwriting agreement.

## Market making

RG 61.13 Underwriting does not include market making activities or trading as principal by brokers. This is because the risk inherent in such activities does not relate to taking up a shortfall on a bona fide offer to intended investors of all the securities of the offer or issue.

## Application of the exemptions

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RG 61.14 In deciding whether a transaction is squarely within the exemptions, the ASC will consider the commercial nature of the transaction rather than its legal form. Factors which it will consider include:

- (a) whether the underwriter engages in underwriting or sub-underwriting as an ordinary part of its business; and, where it does not,
- (b) whether the circumstances surrounding the transaction are more consistent with a bona fide agreement to assume the risk of the shortfall, or with a placement.

RG 61.14A We discuss the rights issue and underwriting exemptions (items 10 and 13 of s611 following the *Corporate Law Economic Reform Program Act 1999*) further in Regulatory Guide 159 *Takeovers, compulsory acquisitions and substantial holdings* at RG 159.152.

[Historical note: RG 61.14A inserted 3/12/2003.]

### Subsection 622(3)

RG 61.15 Section 615 prohibits an acquisition of voting shares in a company if, as a result of the acquisition, a person would be entitled to more than 20% of the voting shares in the company.

RG 61.16 Subsection 622(3) provides an exemption from this prohibition in the case of an acquisition of shares by an allotment to, or purchase of shares by, an underwriter pursuant to:

- “(a) an underwriting agreement particulars of which were set out in a prospectus that has been lodged under Division 2 of Part 7.12... ;  
or
- (b) a sub-underwriting agreement that is related to such an underwriting agreement;

where the prospectus contained an invitation to subscribe for or purchase the shares or an offer to accept subscriptions for or to sell the shares.”

RG 61.17 As s622(3) is limited to an acquisition of shares by allotment or purchase *after* a prospectus has been lodged it cannot apply to the acquisition of shares by an intermediary *before* a prospectus has been lodged. Any form of underwriting in which shares are acquired by the underwriter *after* a prospectus has been lodged may avail itself of the benefit of this exemption.

### Subparagraph 621(1)(b)(ii)

RG 61.18 Subparagraph 621(1)(b)(ii) provides an exemption from the prohibition contained in s615 in the case of an acquisition of shares in a company by an allotment if the requirements set out in s621(2) have been complied with in relation to the allotment and the allotment is made to a person as an underwriter or sub-underwriter in relation to the allotment.

RG 61.19 Section 621 provides an exception to the prohibition in s615 where shares are allotted to members of the company *pari passu* in proportion to their respective shareholdings. Because s621(2)(b) requires that an offer has been made to members (by prospectus) prior to the acquisition by the underwriter, the relief in s621(1)(b)(ii) is not available to an acquisition of shares by an intermediary *before* a prospectus is lodged and issued. Any form of underwriting in which shares are acquired by the underwriter *after* a prospectus may have the benefit of this exemption.

## Paragraph 66(3)(b)

RG 61.20 Section 1017 provides that the provisions relating to prospectuses contained in Div 2 of Pt 7.12 do not apply in relation to:

- (a) an excluded issue of securities;
- (b) an excluded offer of securities for subscription or purchase; or
- (c) an excluded invitation to subscribe for or buy securities.

RG 61.21 An offer or invitation in relation to securities is an excluded offer or an excluded invitation under s66(3)(b) if it is:

- (a) an offer or invitation to enter into an underwriting agreement; or
- (b) made or issued to an underwriter under such an agreement.

In each case the action to which the exemption applies occurs before the subscription for, or purchase of, the shares to which the proposed underwriting agreement relates, whichever form of underwriting is used. Accordingly, the sequence of events under any given form of underwriting does not affect the availability of this exemption. The exemption applies to any legal mechanisms adopted to assume the risk of a shortfall.

## Availability of other exemptions to pre-lodgement underwriting

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RG 61.22 An acquisition of shares by an intermediary prior to the lodgement of a prospectus may be exempted from compliance with s615 under s619. Section 619 provides that s615 does not prohibit the acquisition of shares in a company that does not have more than 15 members.

RG 61.23 An offer of shares to an underwriter before a prospectus is lodged may be exempted from Div 2 of Pt 7.12 whether or not s66(3)(b) applies to pre-lodgement underwriting. These exemptions are contained in:

- (a) s66(3)(a), s66(3)(ba) and reg 7.12.06(b) where the subscription monies payable are at least \$500,000;
- (b) Regulation 7.12.06(a)(i) where the purchaser is the holder of a dealer's licence acting as principal; or
- (c) Regulation 7.12.06(a)(iv) where the purchaser is a trustee of a superannuation fund or an approved deposit fund that has net assets of not less than \$10,000,000.

RG 61.24 Other exemptions contained in Ch 6 and 7 and in the Regulations may also apply to pre-lodgement underwriting depending on the circumstances.

## **Sub-sub-underwriting**

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RG 61.25 Section 9 of the Law defines “underwrite” to “include sub-underwrite”. It does not define “sub-underwrite”.

RG 61.26 A sub-underwriter assumes some or all of the obligations of the underwriter. That is, the sub-underwriter agrees with the underwriter to subscribe for or buy a certain percentage of the shares that the underwriter is obliged to take in the case of a shortfall. The underwriting agreement will normally provide that the underwriter must subscribe for, or nominate other persons to subscribe for, shares the subject of a shortfall. The sub-underwriting agreement will normally provide that the sub-underwriter must subscribe for an agreed number or percentage of shares for which the underwriter must ultimately subscribe or obtain subscriptions. The obligation of the sub-underwriter is therefore to the underwriter. The sub-underwriter is not contractually bound to the issuing company although it will usually subscribe for shares directly from the issuer.

RG 61.27 There is no prima facie reason why “underwrite” should not also include “sub-sub-underwrite”. The definition in s9 is expressed to merely “include” sub-underwriting — it is not exhaustive. As there is no definition of sub-underwrite, this term may encompass all tiers of underwriting other than first tier underwriting.

RG 61.28 Sub-sub-underwriting is relatively uncommon. Like a sub-underwriter (second tier underwriter), lower tier underwriters would subscribe for shares directly from the issuing company. Like the underwriting agreement, the second tier underwriting agreement may provide that the second tier underwriter will subscribe for, or will nominate another person to subscribe for, shares for which the underwriter is bound to subscribe. Lower tier underwriting agreements may contain similar provisions. Generally, a lower tier underwriter is contractually bound only to the underwriter directly above it in the underwriting chain. It would have no contractual obligation to the issuing company.

## Application of the exemptions to sub-sub-underwriting

### ***Subsection 622(3)***

RG 61.29 Subsection 622(3) distinguishes between an underwriting agreement and a sub-underwriting agreement.

RG 61.30 The exemption from s615 applies to underwriting if particulars of the underwriting agreement are set out in the prospectus. Despite the definition of underwriting contained in s9, the use of the terms “underwriting” and “sub-underwriting” in s622(3)(a) and s622(3)(b) respectively indicates that the reference in s622(3)(a) to underwriting does not include a sub-underwriting agreement.

RG 61.31 The second limb (s622(3)(b)) extends the exemption to a “sub-underwriting agreement that is related to such an underwriting agreement”. On the basis that the term “sub-underwriting” applies to all lower tiers of underwriting, the second limb applies to all lower tier underwriting agreements that relate to the agreement or agreements referred to in s622(3)(a).

### ***Subparagraph 621(1)(b)(ii)***

RG 61.32 The references to “underwriter” and “sub-underwriter” in s621(1)(b)(ii) may be seen as references to underwriters at all levels. This is because:

- (a) the definition of “underwrite” may include all tiers of underwriting; and
- (b) a reference to “sub-underwriting” is a reference to all lower tiers of underwriting.

### ***Paragraph 66(3)(b)***

RG 61.33 The reference to “underwriting agreement” in s66(3)(b) may be seen as a reference to an agreement relating to any tier of underwriting. This is because the definition of “underwrite” may include all tiers of underwriting.

## Enforcement

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RG 61.34 The ASC will regard very seriously any attempt to construct agreements which purport to be underwriting agreements in order to avoid the provisions of Ch 6 or 7. Nothing in this guide should be taken to endorse as legal or acceptable any agreement or construction which, while meeting the strict criteria of any type of



agreement described in this guide, appears to be constructed to avoid the provisions of those Chapters under the guise of complying with this guide. To prevent such abuse the ASC will look to the commercial nature of the transaction and whether the underwriter or sub-underwriter normally undertakes such ventures or has a bona fide reason for supporting the issue.

RG 61.35 We discuss our approach to any rights issue or underwriting that falls within the legal terms of the relevant exemptions (items 10 and 13 of s611 following the *Corporate Law Economic Reform Program Act 1999*) but appears to be designed to avoid the purposes of Ch 6 further in Regulatory Guide 159 *Takeovers, compulsory acquisitions and substantial holdings* RG 159.152.

[*Historical note:* RG 61.35 replaced 3/12/2003. The paragraph formerly read: “The ASC also endorses the tenor and intent of NCSC Release 112 ‘Arrangements Contrary to the Purpose of the Takeovers Code — Companies (Acquisition of Shares) Act and Codes s60’. It is reviewing the Release with the intention of issuing an ASC replacement. In the interim the ASC advises that it takes the Release to be a guide to acceptable practices in relation to any form of underwriting and that it will enforce similar standards, either by recourse to the Court or by referral of appropriate matters to the Corporations and Securities Panel.”.]