



Guidance Note 11

Restricted Securities and Voluntary Escrow

Issued: March 2002

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Guidance Note History

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Introduction

1. This Guidance Note is published to assist listed entities to understand how the Australian Stock Exchange Limited (ASX) Listing Rules dealing with restricted securities operate. Generally, the Guidance Note refers to securities issued before an entity is admitted to the official list, but similar principles apply to securities issued by a currently listed entity.
2. Restricted securities are placed in escrow for a specified period (the escrow period). This prevents the transfer of effective ownership or control of them. Escrow is to protect the integrity of the market ASX conducts. For example, escrow delays the time in which a vendor can realise the value of the securities. The delay allows the value of assets or services sold to an entity to become more apparent, and for the market price of the entity's securities to adjust before the vendor receives full consideration. In that way, the business risk is shared between the vendor and other investors.

The Listing Rules

3. Chapter 9 of the Listing Rules deals with restricted securities. There are also requirements in listing rule 15.12 which must be included in an entity's constitution.

4. Restricted securities are defined in listing rule 19.12 which states:
- (a) *+securities issued in the circumstances set out in Appendix 9B.*
 - (b) *+securities that, in ASX's opinion, should be treated as restricted securities.*

Appendix 9B

5. Appendix 9B sets out in tabular form the categories of restricted securities, including securities issued to seed capitalists, vendors of classified assets, promoters, professionals and consultants and persons under an employee incentive scheme. It also sets out whether the securities are restricted and for how long.
6. In addition, listing rule 9.1.3 says that unless ASX decides otherwise, restrictions do not apply to securities issued by the following entities before admission.
- An entity that is admitted under the profit test in listing rule 1.2.
 - An entity that has a track record of profitability or revenue acceptable to ASX.
 - An entity that, in the opinion of ASX, has a substantial proportion of its assets as tangible assets or assets with a readily ascertainable value.

Entities should give ASX all relevant material at the earliest opportunity to enable ASX to determine whether restrictions will apply in each case.

Discretion to treat securities as restricted securities

7. Paragraph (b) of the definition of 'restricted securities' refers to securities that, in ASX's opinion, should be treated as restricted securities. Whether securities are treated as restricted securities is decided on a case by case basis. An example of a situation where ASX may exercise its discretion is where there is a change of activities attracting a requirement to comply with Chapters 1 and 2 of the Listing Rules. This is discussed further at paragraphs 17 to 20. Entities are encouraged to consult ASX about whether ASX will exercise its discretion to treat securities as restricted securities.

Method of restriction

8. An entity must do one of the following in respect of restricted securities, refer listing rules 9.5 and 9.14.
- Issue certificates in respect of the securities. The certificates must be placed with a bank or with a recognised trustee, who must undertake to ASX not to release the certificates without ASX's consent.
 - Enter the securities on the issuer sponsored subregister. The entity must obtain an undertaking from its registry to apply a holding lock to the securities to prevent any movement of the securities from the holding, and not remove the holding lock without ASX's consent, refer listing rule 9.5.

9. ASX will usually only consent to the release of certificates or a holding lock after completion of the escrow period. However, in exceptional circumstances, ASX may consent earlier. One such circumstance is if the restricted securities form part of a deceased estate and the beneficiary enters into a restriction agreement for the balance of the escrow period.

Cash formula

10. Generally, ASX has regard to cash paid for securities when deciding if the securities (or some of them) should be subject to escrow. For example, securities issued to seed capitalists are often issued for less than the issue price paid by subscribers in the initial public offering (IPO). In that case, the proportion of securities issued to the seed capitalist which is likely to be treated as restricted securities is decided by a 'cash formula', as defined in the Listing Rules. The cash formula is:

In the case of +ordinary securities,

$$N = (CP / IPO) \times E$$

- N = the number of shares or units *not* subject to escrow.
- CP = the total cash paid for the +ordinary securities that would otherwise be subject to escrow, divided by the number of +securities issued to the +person.
- IPO = the price paid in any initial public offering at the time the entity applies for admission, or if there is no public offering, the price agreed by ASX.
- E = the number of +ordinary securities that would otherwise be subject to escrow.

In the case of options which have the same terms as options offered with +ordinary securities under any IPO at the time the entity applies for admission,

$$O = N \times F$$

- O = the number of options *not* subject to escrow.
- N = the number of shares or units *not* subject to escrow.
- F = the number of options per +ordinary security offered under the IPO.

Ordinary securities example

11. If a seed capitalist paid \$4,000 for 10,000 shares and the IPO price of the same class of shares was \$1, $N = (4,000/10,000) \times 10,000 = 4,000$. Therefore, 4,000 shares would not be restricted securities. 6,000 shares would be treated as restricted securities. If the proceeds of the issue resulted directly in the entity holding net tangible assets that have a readily ascertainable market value, ASX may treat more, or fewer, securities as restricted securities depending on whether the market value was lower or higher than the amount of cash subscribed. If no market value can be demonstrated to ASX's satisfaction, all the securities may be treated as restricted securities.

Options example

12. Using the example in paragraph 10, if in addition to the 10,000 shares the seed capitalist received 10,000 free attaching options and under the IPO subscribers received one free attaching option for each share subscribed, the following would apply: $O = 4,000 \times 1 = 4,000$. Therefore, 4,000 options would not be restricted securities and 6,000 options would be treated as restricted securities.

Restricted securities issued in satisfaction of debts

13. ASX will usually apply the cash formula to equity securities issued in satisfaction of a debt (that is debt for funds advanced, not debt for services) incurred before listing. The funds must not yet have been utilised by the entity or, if they have been utilised, they must still be represented by net tangible assets of a readily ascertainable market value.

Other matters

Additional disclosures

14. At the time of listing, ASX may require additional information from an entity with restricted securities. For example in the case of a holder of restricted securities who has sold classified assets into an entity, the information required by paragraphs 53 to 61 of Appendix 1A. ASX may require pre-quotations disclosure of that information to the market.

Voting and dividends of restricted securities

15. ASX does not impose any special restrictions on the voting of restricted securities which carry a vote, or on dividends or distributions, unless the restriction agreement is breached. In that case, the restriction agreement and the Listing Rules require that the securities cease to be entitled to a vote and to dividends or distributions, refer listing rules 9.4 and 15.12.3 and clause 11 of Appendix 9A.

Securities issued to an underwriter or sub-underwriter

16. Restricted securities include securities issued to a promoter, refer Appendix 9B, clause 7. A promoter includes a person who provides a service to an entity in relation to the promotion, listing or IPO of an entity, refer paragraph 38. This will include an underwriter and sub-underwriter.

Change of activities

17. Listing rule 11.1 provides that where an entity proposes to make a significant change to the nature or scale of its activities, if ASX requires, it must either hold a meeting of security holders to approve the change, or hold a security holders' meeting and meet the requirements in chapters 1 and 2 as if the entity were applying for admission to the official list. This is discussed further in Guidance Note 12 - Changes to Activities: Listing Rules 11.1, 11.2 and 11.3.
18. Where ASX requires that a security holders' meeting be held, but does not require compliance with Chapters 1 and 2 of the Listing Rules, clauses 5 and 6 of Appendix 9B may apply.
19. Where compliance with Chapters 1 and 2 of the Listing Rules is required, the position is different. Paragraph 6.54 of the Exposure Draft of Listing Rule amendments for 1 July 1998 stated:

“It has always been ASX’s practice to apply, to entities which come within the ambit of rule 11.1.3, the rules and policies concerning restricted securities which are applicable for securities issued prior to admission. ASX does not propose to change this practice. Accordingly, entities to which these rules apply will have the escrow practices of ASX applied to them as far as practicable as if they were a new listing. In doing this ASX recognises that there are difficulties that may arise from case to case. They will be considered in each circumstance.”

20. The above approach generally involves the following.
- Analysis as to whether the business being acquired satisfies any of the bullet points in listing rule 9.1.3.
 - Identification of the clauses in Appendix 9B that would apply if there was a front-door listing.

ASX will exercise its discretion under paragraph (b) of the definition of restricted securities to apply escrow to securities in accordance with the relevant clause of Appendix 9B.

Entities that have been delisted

21. If a promoter seeks to revive a moribund or largely inactive entity that was once listed on ASX (or one of ASX's predecessors), ASX will apply the following policy to the issued securities of that entity.
- Securities issued before the entity was delisted, except those held by current directors, promoters and their associates, will not usually be treated as restricted securities.
 - Securities held by current directors, promoters and their associates, or on-sold by them (see below), will usually be treated as restricted securities. However, ASX will not usually treat securities issued under a recent prospectus as restricted securities.
 - Otherwise, normal considerations usually apply.

For further discussion in relation to the treatment of promoters, refer paragraphs 38 and 39.

22. Note that securities not acquired under a recent prospectus by the existing holders of securities in the moribund or largely inactive entity will not be counted for the purpose of calculating if the entity has sufficient spread of security holders to be admitted, refer listing rule 1.1 condition 7.

Transfer of restricted securities before entering into an escrow deed

23. If securities would have been restricted securities in the hands of one person but have been transferred (eg. on-sold), the securities will usually be restricted securities in the hands of the transferee, refer Appendix 9B, clause 10. This is the case even if the transferee paid as much (or more) for them as was paid for securities issued under a public offering made just before the entity was listed.
24. This is to prevent avoidance of the restricted security provisions. Alternatively, if ASX thinks that securities were transferred to avoid the provisions, it may not admit the entity to the official list.

Relief for charitable donations

25. ASX is prepared to grant an entity relief from escrow to permit gifts for charitable purposes by the entity's security holders. The relief may be granted to an entity seeking listing, or to an already listed entity. The gifts may be of restricted securities or of cash raised from the sale of restricted securities. Where relief is granted to an entity seeking listing, adequate details of the relief must be provided to investors in the entity's prospectus or information memorandum, or its pre-quotation disclosure. Where relief is granted to an already listed entity, an adequate period of notice of the proposed relief must be given to the market to enable the market to adjust to the possibility that securities released from escrow may be sold into the market. A sale of the securities will not be permitted until a reasonable time, depending upon the number of securities and other relevant circumstances, after an announcement has been made to the market of details of the relief. This is discussed further in paragraph 28.

26. The extent of the relief is entirely in ASX's discretion and will depend upon the circumstances of the entity. For example, ASX is unlikely to grant relief to allow persons whose continuing involvement with the entity is integral to its operations to reduce their holdings to an insignificant or nominal level.
27. The gifts must be made to a member of the Trustee Corporations Association of Australia Limited acting as trustee of an umbrella fund for charitable purposes. All of the organisations that may benefit from the umbrella fund must be recognised by the Australian Tax Office under the ROGATE (Registration of Gift Deductible and Income Tax Exempt Charities) provisions of the income tax legislation as having gift deductible status. Adequate evidence that the organisations that may benefit from the fund are limited to organisations with gift deductible status must be provided to ASX. ASX has no objection to a trustee acting on advice from a donor in relation to which organisations with gift deductible status should benefit from the gift.
28. ASX is prepared to consider relief to permit gifts through a variety of means, for example a gift of cash realised from the sale of restricted securities; a gift of restricted securities, on the basis that the securities will be unrestricted in the hands of the trustee for charitable purposes; or an immediate gift of restricted securities on the basis that the securities will be transferred to the trustee for charitable purposes after the escrow period has expired. In all cases adequate notice of the relief must be given to the market before any securities can be sold. What constitutes adequate notice will depend upon the method chosen for making the gift and the circumstances of the entity. For example, where the gift is of securities, the entity and the trustee must enter into an agreement acceptable to ASX in relation to the orderly disposal of any securities which the trustee proposes to sell during the escrow period which would otherwise apply to the securities.
29. For example, the agreement may provide for the trustee to sell a percentage of the securities during the first three month period after transfer to the trustee, and a further percentage of securities in the period from three to six months after transfer to the trustee. There must be disclosure to the market of the agreement between the entity and the trustee and the trustee's intentions in relation to sale of the securities.
30. Where the gift is of cash raised by the sale of securities, the entity and the donor must enter into an agreement for the orderly disposal of the securities within a reasonable period. No sale of securities may be made until a reasonable time after details of the relief have been released to the market, and there must be disclosure to the market of the agreement between the entity and the donor and the donor's intentions in relation to sale of the securities.
31. Entities with security holders who are prospective donors are encouraged to discuss proposals with ASX at an early stage.

Relief for numerous small unrelated parties

32. ASX is prepared to grant relief from escrow requirements to an entity that has many unrelated security holders with small holdings, on the grounds that to require the entity to provide restriction agreements executed by these security holders would impose an undue administrative burden and relief in these circumstances does not derogate from the principles which underlie escrow. Whether relief will be granted, and the form that it takes, will depend upon the circumstances. For example, relief may be granted in relation to numerous unrelated holders with parcels worth less than \$2,000, to numerous unrelated holders with less than a certain number of securities, or numerous unrelated holders where the escrow period would in any event be of short duration.

Voluntary escrow

33. Sometimes voluntary restriction agreements are entered into by security holders. ASX's decision on restrictions will not be influenced by the existence or form of these agreements.
34. Listing rule 8.10.1(i) permits holding locks to be applied to holdings of securities the subject of voluntary escrow and refusal to register any paper-based transfer of securities that are subject to voluntary escrow, where the holder of the securities has consented to this.

Disclosure in relation to restricted securities and securities subject to voluntary escrow

35. ASX considers that disclosure in relation to escrow arrangements and release from escrow provides valuable additional information to the market and promotes transparency. ASX requires the following in relation to both ASX restricted securities and securities subject to voluntary escrow.
- Pre-quotation disclosure of the number of securities subject to escrow and the restriction period applied to those securities.
 - Under listing rule 3.10A, disclosure of any forthcoming release of securities from escrow, not less than ten business days before those securities are released from escrow. In the case of voluntary escrow, the disclosure must be made whether the release is by the expiry of the agreed restriction period, or consent of the parties to early release from voluntary escrow.
 - Under listing rule 4.10.14, disclosure in the annual report of details of securities subject to escrow.
36. Listed entities must ensure that arrangements are in place to comply with the requirements of the rules. In the case of voluntary escrow arrangements, this includes making arrangements with holders of securities to enable the entity to make disclosure in compliance with listing rule 3.10A. Listed entities with escrow arrangements should also diarise the need to take action at least 10 business days before any date of release.

Projects involving tendering for a government licence

37. In the case of an entity that has been granted a licence by an Australian Government to operate a commercial venture (eg, an infrastructure project or casino), ASX will consider not treating securities issued to a seed capitalist as restricted securities if each of the following conditions is met.
- The seed capitalist is not, and has not been, a promoter of the entity, or an associate of a promoter.
 - The seed capitalist is not represented on the board, or involved in the management of the entity; and has not been, and will not be, represented or involved in the first 24 months after the entity is admitted to the official list.
 - The seed capitalist is not an associate of a director of the entity.
 - The securities were issued in fulfilment of subscription commitments between the seed capitalist and the entity to enable the entity to meet the minimum financial criteria needed to tender for the licence. The subscription commitments must have been binding on the seed capitalist. They must not have protected the seed capitalist from adverse changes in financial markets. The subscriptions must have been made in full for cash and the securities issued promptly after the tender was accepted.
38. Entities and their advisers are encouraged to consult ASX at an early stage to determine whether seed capitalists are likely to obtain this relief.

Promoters

39. Promoter is defined in listing rule 19.12 which states:

- (a) *A +person (or associate of a +person) who provides a service to the entity (or to a +related party of the entity) in relation to either of the following or who, in the opinion of ASX, is involved in or has had any influence in either of the following.*
- *The entity's promotion or listing; or*
 - *The entity's initial public offering.*
- (b) *Unless ASX decides otherwise, a +substantial holder (or associate of a +substantial holder) if the person and the person's associates have a relevant interest in at least 10% of the voting +securities at any time in the 12 months before the date of the application for admission to the +official list.*

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Restricted Securities and Voluntary Escrow

40. The effect of paragraph (b) of the definition is that the onus lies on the holder of a 10% or greater interest to establish, to ASX's satisfaction, that the holder has not been involved in or influenced the entity's promotion or listing, or its initial public offering. ASX is likely to accept that the onus has been discharged in the following circumstances.

40.1 The holder has received the securities as vendor securities, and the holder had no previous connection with the entity and has no on-going management role with the entity.

40.2 The holder is a genuine venture capitalist. Factors that ASX will take into account in assessing submissions that the holder is a genuine venture capitalist include the following.

- The holder has a strategy of investing in businesses of the kind conducted by the entity and there are no personal connections between the holder and the founders of the entity.
- The holding does not exceed 30% of voting securities.
- The holder's board representation is limited to one non-executive position.
- The holder has paid issue prices for securities that are comparable to the issue prices paid by other unrelated parties investing at or around the same time and has not obtained any identifiable benefit for itself over and above the benefit of the opportunity to invest in the entity.