ASIC
Australian Securities & Investments Commission

REPORT 368

# Emerging market issuers

August 2013

## About this report

This report sets out key observations from our review of publicly available information on entities listed on Australian markets with a substantial connection to emerging markets.

It identifies some particular challenges these entities may face that are relevant to investor confidence.

**About ASIC regulatory documents**

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers**: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides**: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets**: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports**: describe ASIC compliance or relief activity or the results of a research project.

## Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

# Contents

# Executive summary

1 Not all entities listed on Australian markets operate in Australia. For example, at least one third of entities listed on ASX have either business operations or assets outside Australia.

2 ASIC undertook a focused review of a limited number of listed entities where the operations and assets of the entity are based in Eastern Europe, Asia and the Pacific (excluding Singapore, Hong Kong, Japan and New Zealand), Africa, South America or the Middle East. These jurisdictions are often identified as 'emerging markets'. In this report, these entities are referred to as 'emerging market issuers'.

3 This report describes the size and nature of the emerging market issuer population in Australia and identifies some challenges that these entities face that may have an impact on investors, based on our focused review. Common challenges identified in our review included:

(a) implementing good corporate governance in light of a geographically scattered board with limited financial resources;

(b) implementing effective internal controls and risk management systems where operations are geographically diverse;

(c) operating through complex ownership or contractual arrangements in response to laws in some jurisdictions that limit the ownership of assets by foreign entities;

(d) relying on one or two key individuals located outside Australia, which raises the risk of substantial transactions benefiting those individuals; and

(e) a company or its auditor verifying information or opinions about the entity's operations and performance provided by experts or professionals in an overseas jurisdiction.

4 These challenges are similar to those identified by various overseas regulators looking at these issues. Where these challenges are material, emerging market issuers need to take steps to respond. These steps may include implementing appropriate internal controls and risk management systems, and making appropriate disclosure to investors, consistent with a market exchange's listing rules and ASIC's published regulatory guidance on prospectuses, control transactions and related party transactions.

5 While reviewing disclosure documents lodged with ASIC by emerging market issuers, ASIC has secured additional or corrective disclosure concerning the matters identified above.

6 Our review, in conjunction with the work of overseas regulators, has increased our understanding of the challenges faced by emerging market issuers, and the

key areas we need to focus on. We will continue to raise concerns in relation to lodged documents about the disclosure of material challenges facing particular issuers to ensure that investors have the information they reasonably require to make informed investment decisions.

# A Background

**Key points**

Many entities listed on Australian markets have connections to emerging markets. This reflects the growth in emerging markets and the significance of mining and resources markets in our economy.

ASIC has reviewed the role of emerging market issuers in Australia. There has also been extensive work in other countries on emerging market issuers—in part, because of significant scandals and failures overseas.

The regulatory framework of our public capital markets, which is focused on disclosure, means that there are few barriers for emerging market issuers in accessing capital in Australia. This means that listing rules in Australia (e.g. the ASX Listing Rules) have a key role to play in maintaining investor confidence, particularly for entities not incorporated in Australia.

## The global economy

7 It is not surprising that, in a global economy, many entities listed on Australian markets operate beyond Australia. International expansion provides opportunities for entities to expand into new markets to produce, acquire or sell their goods or services, or to raise capital.

8 The Australian Government has made it clear that Australia can seek to play an important role in the Asia–Pacific region, and that Australian entities should leverage off our location and develop greater knowledge and expertise in these markets.[1]

9 In recent years, with growth in Western economies slowing, the substantial growth occurring in emerging markets (particularly in India and China) has been of greater economic significance. Direct and indirect investment in emerging markets has increased as investors seek to participate in markets with higher growth potential.

10 The resources sector has been viewed as one of these growth markets, with approximately 45% of the entities listed on ASX primarily engaged in the resources sector.[2] Many emerging markets have resource wealth that has not yet been fully developed and, consequently, they are an important source of growth for resource entities. With such a large listed resources sector, it is

[1] Australian Government, *Australia in the Asian century*, white paper, October 2012, http://asiancentury.dpmc.gov.au/white-paper.
[2] ASX, *ASX: An international centre for resources capital*, brochure, 2010, http://www.asx.com.au/images/resources/resources_brochure.pdf.

natural that investment in emerging markets by listed entities in Australia is significant.

11 The high-profile collapse in 2011 of Sino-Forest Corporation (Sino-Forest), a company listed on the Toronto Stock Exchange (TSX) that once had a market capitalisation of C$6 billion, has focused the attention of regulators worldwide on the risks faced by those investing in emerging market issuers: see paragraphs 19–22.

## Our review of emerging market issuers

12 ASIC has undertaken a high-level review of emerging market issuers in Australia generally. In addition to identifying the emerging market issuer population, we reviewed the conduct and disclosure of a limited sample of ASX-listed emerging market issuers based on publicly available information.

13 We use the term 'emerging market issuers' throughout this report to refer to listed entities that have:

(a) material assets located in, or a revenue stream derived from operations in, an emerging market; or

(b) subsidiaries incorporated in and/or listed in an emerging market.

14 In addition, emerging market issuers may have directors or senior management based offshore in an emerging market, or engage an auditor from an emerging market.

15 We focused on ASX-listed entities in our review because information about these entities is more accessible, and listing on a market suggests retail investor participation through capital raisings. In addition, investor expectations about listed entities are generally higher than for unlisted entities. This means that concerns about listed entities may have a more negative impact on investor confidence in the Australian market. Although other markets operate in Australia, the number of listings on these markets is far below that of ASX. We therefore limited our review to ASX-listed entities.[3]

16 We started our review by identifying all ASX-listed entities that reported having an accounting segment in an emerging market or had subsidiaries incorporated there. This yielded 760 entities as at November 2012. We then sought to narrow down the population to allow us to identify some key challenges that emerging market issuers face. We removed entities that we considered had good market oversight and scrutiny, whose market

[3] ASIC has also considered, in the course of our business-as-usual work, the conduct and disclosure of entities that are listed on other exchanges but that are outside the terms of this review.

capitalisation was so small that they would be considered a speculative investment, and whose investment in emerging markets was not material to their financial position or performance.

17 From this smaller list of ASX-listed emerging market issuers, we reviewed the public disclosure of a limited number of targeted entities to identify challenges that may arise with greater frequency in this population. Concurrently, we also considered the work of overseas regulators and identified some common themes in our observations.

18 For key observations from our review, see Section B of this report. For responses to these challenges, see Section C.

## Reviews by overseas regulators

19 The scope of the work of overseas regulators in this area has differed, in the same way that the extent of participation, the challenges identified and local experiences with emerging market issuers has varied.

20 In reviewing the work of overseas regulators on emerging market issuers, it is clear that 'back-door' listings or reverse mergers are an area of focus in other jurisdictions. In international markets, these arrangements are being used to facilitate listings for emerging market issuers that may not otherwise get through the 'front door'.

21 We consider that this is not as significant an issue in Australia because of the requirements in the ASX Listing Rules. For example, ASX has a discretion under ASX Listing Rule 11.1.3 to require a listed entity used as a vehicle for a back-door listing to re-comply with the admission requirements.[4]

22 For a short overview of some of the more significant work undertaken by overseas regulators in this area, see Appendix 1 of this report.

## Regulatory framework in Australia

23 The primary regulation of emerging market issuers in Australia in terms of corporate governance and disclosure is through the *Corporations Act 2001* (Corporations Act) and through market listing rules (e.g. the ASX Listing Rules). This regulatory framework sets out how emerging market issuers can raise money and conduct other transactions, and the corporate governance and reporting obligations that apply to them.

[4] See also ASX Guidance Note 12 *Significant changes to activities* (GN 12), http://www.asxgroup.com.au/media/PDFs/gn12_changes_to_activities.pdf.

24 One of the significant features of Australia's regulatory framework is that the place of incorporation of a company is not relevant in determining whether a public securities offering can be made. Some specific listing requirements are imposed on emerging market issuers not incorporated in Australia, but these entities can make public offers if they meet the requirements of our disclosure regime, as set out in a market's listing rules, at the time they seek quotation. These rules play a key role in ensuring that investors receive ongoing disclosure of sufficient quantity and quality, and that there is adequate accountability to members.

25 It is important for investors to understand that emerging market issuers not incorporated in Australia can be listed here, even though many of the governance protections that are contained in the Corporations Act do not apply to these entities. For example, the related party transaction provisions, takeover laws, continuous disclosure obligations and the financial reporting requirements under the Corporations Act do not generally apply to emerging market issuers incorporated outside Australia. Further, the Corporations Act does not regulate the conduct of auditors operating outside Australia.

26 Emerging market issuers that are incorporated in Australia are subject to the full corporate governance provisions of the Corporations Act, offering more comfort and certainty to Australian investors that certain standards they are familiar with will be met.

27 For example, emerging market issuers incorporated in Australia must meet the requirement in the Corporations Act that a public company have at least two directors that ordinarily reside in Australia. This gives investors some comfort that there will be directors who are both accessible in Australia and familiar with the Australian regulatory environment.

28 However, even if an emerging market issuer is incorporated in Australia, the ability of Australian regulators to take action to enforce legislative requirements may be limited because of the nature and location of the issuer and its key management personnel.

29 For a brief discussion of the key aspects of the regulatory framework in Australia that may apply to emerging market issuers, see Appendix 2 to this report.

# B Key observations about emerging market issuers in Australia

**Key points**

By reviewing publicly available information, we identified 760 ASX-listed entities that have a connection to emerging markets. Further investigation revealed that most of these entities are incorporated in Australia, with the majority operating in the resources sector.

Our review of public disclosure by a limited number of these emerging market issuers highlighted that these entities face challenges relating to:

- corporate governance;
- internal controls and risk management;
- ownership of assets;
- related party transactions, resulting from reliance on a few key individuals; and
- verification of information or opinions.

## Characteristics of the review sample

30 Using the criteria described in paragraph 16, we identified 760 emerging market issuers listed on ASX in November 2012. At that time, there were approximately 2,100 entities listed on ASX, so the emerging market issuer population represented at least one third of all ASX listings.

31 Of the 760 emerging market issuers identified in our review:

(a) 58% had a market capitalisation of less than A$50 million;

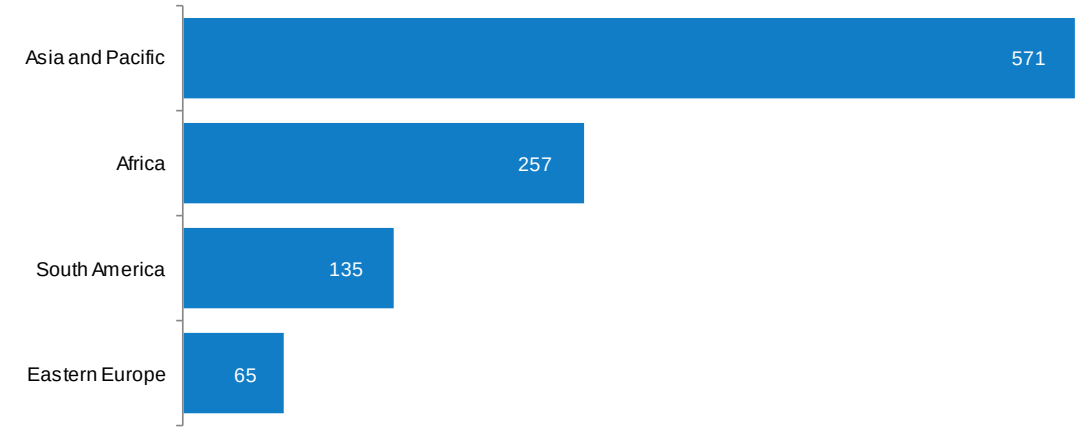
(b) Asia and the Pacific was the largest emerging market, followed by Africa (see Figure 1);

(c) more than 56% are predominantly involved in the mineral exploration and mining, or oil and gas sectors (see Figure 2); and

(d) over 90% are incorporated in Australia.[5]

[5] Of the entities incorporated outside Australia, most are incorporated in established markets such as Canada, New Zealand, the United Kingdom and Hong Kong, or known tax havens such as Bermuda, British Virgin Islands and the Channel Islands. Only a small number of these entities are actually incorporated in emerging markets. The number registered in each of these jurisdictions is statistically insignificant.

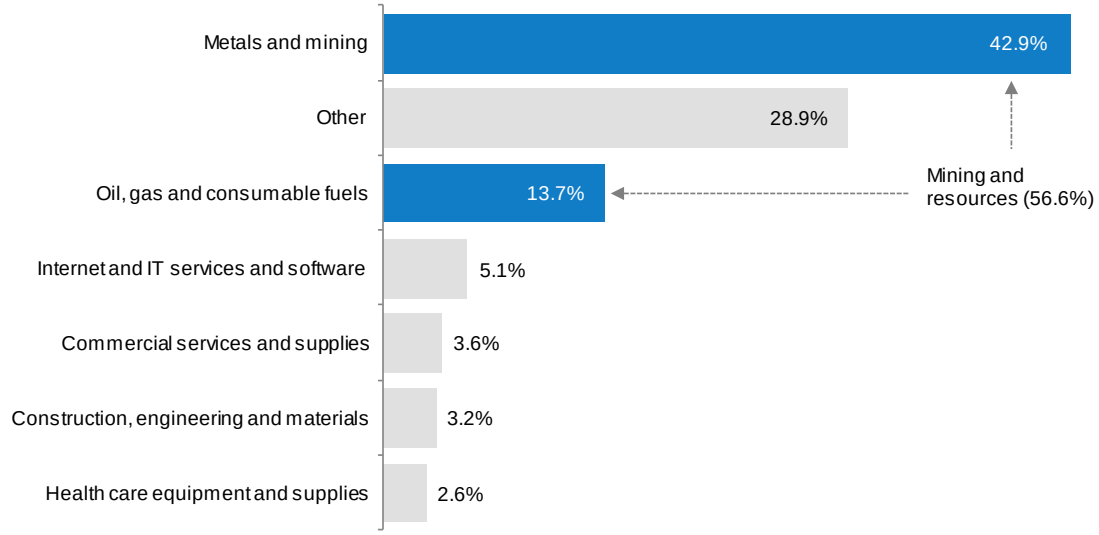
**Figure 1: ASX-listed emerging market issuers by region**




Note 1: Asia and Pacific excludes Hong Kong, Singapore, Japan and New Zealand.

Note 2: The numbers represented in the figure indicate the number of entities that have operations in each jurisdiction. Some entities operate in more than one emerging market, and their operations were counted in each of the markets in which they operate. Accordingly, these figures do not total 760. We did not assess which emerging market was the predominant market.

**Figure 2: ASX-listed emerging market issuers by sector**




32 We observed that a number of the 760 entities had a listing on at least one other overseas exchange in addition to a listing on ASX. For these entities, the overseas exchanges with the largest representation were Toronto, Frankfurt and Berlin. Together, these three exchanges represented more than half of the overseas listings.

33 We also reviewed the public disclosure of a limited group of emerging market issuers to identify the challenges facing these entities and to assess how well these challenges have been disclosed to members.

34 From our review of public announcements and documents, we observed that an emerging market issuer is likely to encounter the following challenges, relating to:

(a) corporate governance;

(b) internal controls and risk management;

(c) ownership of assets where restrictions on foreign ownership exist;

(d) related party transactions, particularly where the entity is reliant on one or two key individuals; and

(e) verification of information or opinions provided by experts or professionals in an overseas jurisdiction.

35 These challenges may also arise for entities that are not emerging market issuers. However, because of the frequency of their occurrence in the emerging market issuer population in Australia and the particular way in which these challenges are manifest, we think it is important to raise awareness of their impact on emerging market issuers.

## Corporate governance

36 As gatekeepers of transparency and accountability in the major financial and business dealings of an entity, directors are responsible for corporate governance. This involves directors remaining active, informed and competent in the oversight of an entity. For a variety of reasons, emerging market issuers may face challenges to good corporate governance.

37 Our observations on the adoption of selected ASX Corporate Governance Principles and Best Practice Recommendations (ASX Principles and Recommendations) by the emerging market issuers considered in our review are set out below.

### Structuring the board to add value

38 We observed that most entities we reviewed did not have a board with a majority of independent directors, nor did they have an independent chair of the board. This is unsurprising, given that many emerging market issuers have limited resources and small boards. Most entities did, however, appoint different persons to perform the role of chair and chief executive officer (CEO) or managing director.

39 We also observed a small number of entities incorporated in Australia that did not have two directors ordinarily resident in Australia, which is required under s201A of the Corporations Act (see paragraph 101 in relation to action ASIC has taken on this matter).

### Financial reporting

40 Because many emerging market issuers have a market capitalisation of less than A$50 million, they are likely to struggle to have the financial resources

and board size to implement many of the ASX Principles and Recommendations. The size and scope of an emerging market issuer's business was the most common reason provided for not adopting ASX's recommendation on the formation and composition of an audit committee.

41 A number of emerging market issuers stated that having an audit committee would not improve the effectiveness or efficiency of the entity's audit function. While more than half of the entities reviewed did form an audit committee, most did not meet ASX's recommendation on the composition of this committee.

### Continuous disclosure

42 Being geographically spread out may also pose challenges for a company in facilitating timely and meaningful disclosure to the market.

43 In reviewing disclosure against the ASX Principles and Recommendations, almost all the entities reviewed stated that they had a documented policy to ensure that they complied with ASX's recommendation on timely and balanced disclosure. However, these policies were not always summarised or provided in full text on the company website for an investor to review.

44 Despite these statements, we observed that almost a third of the emerging market issuers we reviewed did not make frequent or meaningful continuous disclosure.

45 We observed that some entities made fewer than 20 announcements on ASX's market announcement platform in a given calendar year. Within the scope of this review, it was not possible to determine why these emerging market issuers appeared to make such infrequent continuous disclosure.

## Internal controls and risk management

46 The business of operating across borders requires efficient internal controls and risk management systems. For example, an emerging market issuer may have to operate in a variety of languages, currencies, and political and legal systems. Entities must be diligent to prevent miscommunication, or fraud by officers or external parties, and to ensure that funds are not lost through poor currency management.

47 These challenges may be more pronounced for emerging market issuers if they do not have the financial resources to develop robust internal controls to minimise or mitigate these risks.

48 The scope of our review did not involve obtaining non-public information about the internal controls and risk management systems of the emerging market issuers reviewed. However, we did observe some media reports that

may indicate that some entities suffered loss as a result of inadequate internal controls.

49 In addition, we have observed that emerging market issuers may have a high level of reliance on a key person overseas to either manage financial resources, report on operations to the board, or manage relationships in that jurisdiction.

50 Of the entities reviewed, most entities reported in their annual report that they had adopted ASX's recommendation on risk management and internal controls.[6] This involves establishing policies for the oversight and management of material business risks. The board requires management to design and implement risk management and internal controls, and report on whether those risks are being managed effectively. Some of these policies have been made publicly available on the company website, and others were summarised in varying degrees of detail in the annual report.

## Ownership of assets

51 Emerging market issuers face challenges when conducting business overseas because of differences in the legal and regulatory environments in which they operate.

52 While other listed entities may also use complex structures, we observed that some emerging market issuers use complex structures to accommodate restrictions on the foreign ownership of assets. This can result in an emerging market issuer not holding a direct ownership interest in its principal asset, but instead holding rights indirectly through contractual agreements with a foreign entity. Alternatively, it may hold a direct interest, but with a lower level of control—generally less than 50%.

53 Such corporate structures create a number of challenges for an emerging market issuer, including that:

(a) title and control over assets may be compromised;

(b) the structure may limit or prevent members having recourse against the assets held by the foreign partner;

(c) the structure may affect the ability of the board to properly oversee the management and operations of the entity; or

(d) the structure may have the potential to facilitate fraud or the misappropriation of assets.

54 We are aware that, while they are sometimes necessary, complex corporate structures can pose significant risks to the entity and members.

[6] ASX, ASX Principles and Recommendations, *Principle 7: Recognise and manage risk.*

55 A recent survey report by KPMG on small and mid-tier energy and resource companies has found that small companies are more likely to lack formal controls over bribery or corruption, regardless of where they operate.[7] The survey report states (at page 45) that, 'this is an area which is growing in importance because of increasing scrutiny and the potential for criminal penalties for directors'.

56 We have observed that, in some circumstances, these risks and challenges could be more effectively disclosed to investors.

## Related party transactions

57 Boards have the primary role in making decisions about related party transactions and it is expected that, where possible, independent directors with no material personal interest in the transaction will play a central role in monitoring such transactions. We expect non-associated directors to carefully scrutinise the fairness and the impact of any related party transactions.

58 Although not unique to emerging market issuers, we observed that, where an entity is reliant on the guidance and connections of one or two key individuals, there is a greater likelihood that related party transactions providing substantial financial benefits to those persons will occur.

59 We consider this poses a greater challenge for emerging market issuers to manage if key persons are operating in an overseas jurisdiction. This is because there may be less oversight of the person's actions or a higher level of reliance on that person's business connections or expertise. In some emerging market issuers, we observed a high level of concentrated ownership, often with parties associated with a related party director.

60 We identified a high incidence of related party transactions in the emerging market issuers we reviewed. We also observed that, in many cases, these entities did not seek shareholder approval under Ch 2E of the Corporations Act for the related party transactions, even where the transaction appeared to have a significant material impact on the entity, operationally and financially. These entities instead sought approval under ASX Listing Rule 10.11, as required, but did not seek approval under Ch 2E.

61 We presume that approval under Ch 2E was not sought in the cases we identified because the board was of the view that it could rely on the arm's length exception in s210 of the Corporations Act. Without review of further non-public information, we did not assess whether the arm's length exception had been appropriately relied on in all cases. It is likely that members of the company would be similarly unable to determine the reasons

[7] KPMG, *Corporate governance for small and mid-tier energy and resource companies*, survey report, August 2013.

that such transactions were not put to a shareholder vote. We consider that boards entering into transactions of this type should be especially vigilant in ensuring that members are adequately informed of the reasons for the board's decisions.

## Verification of information or opinions

62 Independent third parties, such as auditors, may face challenges in accessing reliable information because of the operation of laws in an overseas jurisdiction, or by being overly reliant on the information supplied by key persons located in an emerging market. The ability of independent third parties to verify and robustly test the reliability of information is a crucial part of the credibility of disclosures made by emerging market issuers.

63 On the basis of the publicly available information, we were unable to make any observations about emerging market issuers and their ability to verify information they relied on from emerging markets. Accordingly, we emphasise the important role that auditors play in ensuring that investors are confident and informed, particularly where the physical location of the business means that investors have little day-to-day visibility of operations.

64 While the scope of our review did not extend to seeking audit working papers of the emerging market issuers we reviewed, recent work by ASIC on audit quality raises concerns about how effectively auditors are obtaining assurance about operations and assets in emerging markets.

65 In December 2012, we published the findings of our annual review of audit files: see Report 317 *Audit inspection program report for 2011–12* (REP 317).[8] The three broad areas requiring improvement by audit firms were:

(a) the sufficiency and appropriateness of audit evidence obtained by the auditor;

(b) the level of professional scepticism exercised by auditors; and

(c) the extent of reliance that can be placed on the work of other auditors and experts.

66 For an auditor to rely on the work of other auditors and experts, the auditor needs to assess their competence and objectivity, and evaluate the appropriateness of the work performed by them.

67 In REP 317, we identified instances where the audit files did not contain sufficient appropriate evidence of:

[8] ASIC, Report 317 *Audit inspection program report for 2011–12* (REP 317), December 2012, www.asic.gov.au/reportshttp://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep317-published-4-December-2012.pdf/$file/rep317-published-4-December-2012.pdf.

(a) the auditor's evaluation of the competence and independence of component auditors, and the evaluation of the component auditors' work, including the resolution of matters raised by component auditors;

(b) the auditor's evaluation of the adequacy and reliability of the work of experts engaged by the audited entity; and

(c) the appropriate translation of source documents (e.g. bank statements) from a foreign language into English.

68 We also note changes in the recently reissued ASX Guidance Note 1 *Applying for admission and quotation* (GN 1).[9] GN 1 states that, in certain cases, ASX may require the disclosure of additional information under ASX Listing Rule 1.17 about the qualifications and experience of the auditor of an entity applying for admission to the official list, and of the accountants and auditors who prepared, audited or reviewed financial documents provided as part of the admission process.

## Findings of overseas regulators

69 A number of the challenges we identified that emerging market issuers may face have also been identified as challenges in overseas jurisdictions.

70 Related party transactions are an area of concern identified by the Ontario Securities Commission (OSC) in Canada. Its review of emerging market issuers noted that this is an area that needs to be understood and disclosed accurately. Its concern stemmed from the potential differences between local business practices and cultural norms, and the legal requirements in Canada, and those in overseas jurisdictions.

71 The role of the auditor in verifying the ownership and value of assets is currently being closely scrutinised in Canada, with legal action being brought by the OSC against the auditors of Sino-Forest. In that case, the regulator alleges that the auditor:

(a) failed to perform sufficient audit work to verify Sino-Forest's ownership of its most significant assets;

(b) failed to perform sufficient audit work to verify the existence of Sino-Forest's most significant assets; and

(c) failed to undertake the audit work on the Sino-Forest engagement with a sufficient level of professional scepticism.

72 The question of audit quality and, in particular, verification of the work of component auditors in emerging markets is not just a matter that is of concern in Canada, but also to regulators in Hong Kong and the United States.

[9] ASX Guidance Note 1 *Applying for admission and quotation* (GN 1), http://www.asxgroup.com.au/media/PDFs/gn01_admission.pdf.

73 For a short overview of some of the more significant work undertaken by overseas regulators in this area, see Appendix 1 of this report.

# C Responding to the challenges

**Key points**

An important factor for emerging market issuers in maintaining investor confidence is compliance with the Australian regulatory system, to the extent that it applies to them. This includes requirements relating to:

- corporate governance;
- conflicts of interest;
- disclosure; and
- financial reporting.

The key observations from our review of emerging market issuers will inform our work in 2013–14 on conduct and disclosure issues.

We will also continue to work collaboratively with ASX and other Australian markets, and liaise with and draw on the experience of overseas regulators, on issues that are relevant to emerging market issuers.

## Action for emerging market issuers and their advisers

74 An important factor for emerging market issuers in maintaining investor confidence is compliance with the Australian regulatory system, to the extent that it applies to them. We note that even those emerging market issuers not incorporated in Australia are subject to significant regulatory requirements under, for example, the ASX Listing Rules and, to a lesser extent, the Corporations Act.

75 Emerging market issuers need to both understand these regulatory requirements and tailor their compliance arrangements so that they take into account the practical issues they face, given that their operations or assets, or directors and senior management may be based in emerging markets. Appropriate advice, particularly for those unfamiliar with the legal requirements in Australia, may greatly assist emerging market issuers in understanding these regulatory requirements.

76 In our review, we identified a number of instances where emerging market issuers appeared not to be sufficiently aware of their legal obligations and may not have been in compliance with the Corporations Act. The areas in need of particular focus involve corporate governance, conflicts of interest, disclosure and financial reporting.

## Corporate governance

77 Emerging market issuers should consider the difficult issues they may encounter as a result of their connection with an emerging market. In addition, they must consider the extent of the entity's and board's legal obligations in their home jurisdiction (which is generally Australia) and the emerging markets in which they operate, and how to manage the associated risks.

78 Emerging market issuers should ensure that they receive appropriate independent advice in the emerging markets in which they operate, so they are well informed of any legal impediments to conducting their business and discharging their legal obligations in that jurisdiction.

79 Good advice will assist directors and management in making decisions on other more day-to-day matters affecting the business and good governance in general. For example, advice on how to structure the holding of foreign assets may minimise the risk of loss to an entity if it does not hold a majority interest in a venture.

80 The Australian Government's white paper recommendations include:

(a) encouraging corporate boards to include more business people with direct expertise from within the region;

(b) integrating Asian cultural competency training into courses offered by the Australian Institute of Company Directors; and

(c) advocating continued efforts to promote joint standard-setting work and international standards.

## Conflicts of interest

81 The challenges for emerging market issuers associated with corporate governance, internal controls and reliance on key persons located outside Australia may mean that an emerging market issuer needs to focus on obligations relating to conflicts of interest.

82 In particular, the different cultures and legal systems involved in working across borders may mean that, for related party transactions, boards of entities incorporated in Australia must robustly consider whether reliance on the arm's length exception in the Corporations Act is reasonable, or whether a related party transaction disclosed in adequate detail should be put to members for approval. This is consistent with our guidance in Regulatory Guide 76 *Related party transactions* (RG 76).[10] If in doubt, such transactions should be put to members for approval.

[10] ASIC, Regulatory Guide 76 *Related party transactions* (RG 76), www.asic.gov.au/rg.

83 All emerging market issuers, whether incorporated in Australia or not, may need to think carefully about identifying related party transactions for the purposes of complying with ASX Listing Rule 10.1.

84 General directors' duties and material personal interest voting restrictions for directors may also need to be a focus where there is significant reliance on one key director in an emerging market. It may not always be easy to identify circumstances in which the director is personally interested in a matter for decision. Cultural differences on acceptable business practices may also contribute to the difficulties in implementing practices that meet the expectations of Australian investors.

## Disclosure

85 In seeking to raise capital from investors, emerging market issuers should ensure that the disclosure document used is an accurate reflection of the business undertaken by the entity and the risks associated with this business.

86 It may be particularly important that adequate verification of assets and ownership is undertaken as part of a due diligence process in preparing a disclosure document. This will minimise the risk of misleading representations about these matters being made in a disclosure document.

87 We have issued regulatory guidance on prospectus disclosure: see Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228).[11] This guidance emphasises that investors should be provided with an overview that presents key information in a balanced way, and that risk disclosure should be specific (e.g. explaining the consequences of the risk occurring) and sufficient prominence given to key risks.

88 For a particular business, the challenges identified through our review of emerging market issuers may well give rise to a key risk for that issuer. Accordingly, consideration of these challenges and any risks arising from them for a particular issuer should be part of the work undertaken by an emerging market issuer and their advisers in preparing a disclosure document for investors.

89 When raising money in Australia, emerging market issuers that are not incorporated in Australia may need to clearly communicate to investors the risk that there is less investor protection than for investors in an Australian company: see RG 228, Table 7.[12]

[11] ASIC, Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228), www.asic.gov.au/rg.
[12] See also ASX Guidance Note 4 *Foreign entities* (GN 4), http://www.asxgroup.com.au/media/PDFs/gn04_foreign_entities.pdf. This now requires emerging market issuers to make certain disclosures, such as the place of incorporation and a concise summary of the rights and obligations of members under the law of their home jurisdiction, including how the disclosure of interests and takeovers are regulated.

90 Similar issues arise in control transactions where an emerging market issuer acquirer offers scrip as consideration.

91 In relation to ongoing periodic and continuous disclosure, we note that having systems in place for the timely provision of information within an emerging market issuer is important.[13] If there are material operations in an emerging market, systems need to be in place to ensure that information that must be disclosed to the market is communicated promptly to persons able to authorise disclosure to the market.

92 In addition, it is important that emerging market issuers ensure that their disclosure is made in English and represents financial amounts in Australian dollars for consideration by Australian retail investors.

### Periodic reporting to an exchange

93 The corporate governance and internal control challenges described in Section B of this report are also relevant for financial reporting disclosure.

94 Unless steps are taken to address these challenges, the reliability of financial reporting may fall below the standard required by the Corporations Act (as applicable). For all emerging market issuers, whether or not they are incorporated in Australia, providing financial reporting information of low quality may result in the market being misled.

## Regulatory response

### Conduct and disclosure

95 The key observations from our review of emerging market issuers will inform our work on conduct and disclosure. For example, in the past year, we have secured further disclosure on the business operations and risks associated with a number of emerging market issuers in their initial public offer prospectuses. In other instances, where ASIC has sought additional disclosure and our concerns have not been addressed, we have made orders and the associated listings did not proceed.

96 While we are not a merit regulator, through our disclosure work we aim to ensure that investors fully understand the merits of the investment opportunity available to them and make decisions accordingly.

97 Our review, and the work of overseas regulators, has given us a better understanding of the challenges that emerging market issuers may face. While these challenges are not necessarily unique to emerging market

[13] See ASX Guidance Note 8 *Continuous disclosure: Listing Rules 3.1–3.1B* (GN 8), http://www.asxgroup.com.au/media/PDFs/gn08_continuous_disclosure.pdf. This is an area where a number of emerging market issuers could improve their compliance.

issuers, they may occur more frequently and with greater impact for these entities. Although we may not review every prospectus lodged with us, one of our priorities in 2013–14 is to review the adequacy of disclosure in fundraising documents from emerging market issuers, or where scrip in an emerging market issuer is offered as consideration in a takeover or scheme of arrangement.

98 When reviewing disclosure documents, we will take into account the challenges we have identified and consider whether the disclosure is adequate to describe the entity's business and the key risks it may face. Where we consider that disclosure of these matters may be misleading, omits material information or is not clear, we will use our regulatory powers to seek additional or clearer disclosure. This includes obtaining documents under compulsory notice to test the disclosures made, using fundraising orders where appropriate, or applying to the Takeovers Panel for a declaration of unacceptable circumstances.

99 From time to time, as necessary, we will engage with overseas regulators and, under the terms of the International Organization of Securities Commission's (IOSCO) multilateral memorandum of understanding, we will seek assistance in obtaining information on the overseas operations or identities of an emerging market issuer.

100 We have referred continuous disclosure matters, identified through our review, to ASX for further assessment and engagement with the entities concerned. ASIC will continue to engage with, and work collaboratively with, ASX and other Australian markets on issues that are relevant to emerging market issuers fulfilling their disclosure and corporate governance obligations.

101 ASIC has also corresponded with the entities identified in our review as currently not having two directors ordinarily resident in Australia about their apparent non-compliance with s201A of the Corporations Act and about the steps they are taking to ensure compliance.

## Audit surveillance program

102 Auditors play an important role in assuring the quality of financial reporting disclosure. Audit quality is an area of concern more generally for us, but there are specific challenges arising from reliance on the work of component auditors that are relevant for emerging market issuers.

103 Reliance on the work of component auditors remains a focus for ASIC in our audit inspection program for the 2013–14 financial year. Through this work, we hope to improve the audit profession's focus on the need to use component audit work appropriately.

## Regulatory approach of overseas regulators

104 As discussed in Section A of this report, as part of our review of emerging market issuers in the Australian context, we considered the experiences of

overseas regulators in Canada, the United States, United Kingdom, Hong Kong and Singapore. We looked at some corporate failings by emerging market issuers in these markets, the background to those failings, and also what regulatory approaches are being taken in these jurisdictions. For a short overview of some of the more significant work undertaken by overseas regulators, see Appendix 1 to this report.

105 Each jurisdiction has had different experiences with emerging market issuers, which have influenced the way that regulators have approached the regulation of these entities:

(a) The TSX and TSX Venture Exchange (TSXV) in Canada have consulted on implementing listing rules governing the listing of emerging market issuers.[14]

(b) The Financial Services Authority (FSA) in the United Kingdom has imposed restrictions on externally managed companies from obtaining a premium listing on the London Stock Exchange.[15]

(c) The Securities and Exchange Commission (SEC) in the United States has issued an investor bulletin on reverse mergers,[16] and approved new rules to toughen listing standards for reverse merger entities.[17]

106 As discussed at paragraphs 69–73, in some aspects, the challenges identified by overseas regulators are similar to those identified by ASIC in our review.

107 One point of distinction is that Australia does not appear to face the same challenges with back-door listings as do some overseas regulators. This may be because of ASX's administration of ASX Guidance Note 12 *Significant changes to activities* (GN 12) and its discretion under ASX Listing Rule 11.1.3 to require a listed entity facilitating a back-door listing to re-comply with the admission requirements.

108 Many jurisdictions are publishing information for investors, aimed at raising awareness of the unique challenges and risks involved in investing in emerging market issuers. We recently published on our MoneySmart website a webpage for retail investors on emerging market issuers and what investors should consider when reading a disclosure document before investing in these entities.[18]

---

[14] **Error! Hyperlink reference not valid.**TSX/TSXV, *Consultation paper on emerging market issuers*, December 2012, http://tmx.com/en/pdf/Joint-Consultation-Paper.pdf.
[15] FSA, Consultation Paper 12/2 *Amendments to the listing rules, prospectus rules, disclosure rules and transparency rules*, January 2012, http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/cp/cp12_02.pdf.
[16] SEC, *Investor bulletin on reverse mergers*, June 2011, http://www.sec.gov/investor/alerts/reversemergers.pdf.
[17] SEC, *SEC approves new rules to toughen listing standards for reverse merger companies*, press release, 9 November 2011, http://www.sec.gov/news/press/2011/2011-235.htm.
[18] ASIC, 'Emerging market companies: Companies operating in emerging markets', webpage, **Error! Hyperlink reference not valid.**https://www.moneysmart.gov.au/investing/shares/choosing-shares-to-buy/emerging-market-companies.

# Key terms

| Term | Meaning in this document |
|---|---|
| ASIC | Australian Securities and Investments Commission |
| ASX | ASX Limited or the exchange market operated by ASX Limited |
| ASX Listing Rule 11.1.3 (for example) | A rule of the ASX Listing Rules (in this example numbered 11.1.3) |
| ASX Principles and Recommendations | ASX Corporate Governance Principles and Best Practice Recommendations |
| back-door listing | A process where a person seeks to have an asset or business listed on an exchange by injecting the asset or business into an existing listed entity, rather than through the conventional process of applying to be admitted to the official list as a new entity |
| Ch 2E (for example) | A chapter of the Corporations Act (in this example numbered 2E) |
| Corporations Act | *Corporations Act 2001*, including regulations made for the purposes of that Act |
| CPAB | Canadian Public Accountability Board |
| emerging market | A jurisdiction in Eastern Europe, Asia and the Pacific (excluding Singapore, Hong Kong, Japan and New Zealand), Africa, South America or the Middle East |
| emerging market issuer | A listed entity that has:<br>• material assets located in, or a revenue stream derived from operations in, an emerging market; or<br>• subsidiaries incorporated in and/or listed in an emerging market.<br>In addition, emerging market issuers may have directors or senior management based offshore in an emerging market, or engage an auditor from an emerging market |
| FSA | Financial Services Authority (UK)—now the Financial Conduct Authority (FCA) |
| FTSE 100 | The key index of the London Stock Exchange |
| GN 1 (for example) | An ASX guidance note (in this example numbered 1) |
| HKEx | Hong Kong Stock Exchange |
| IOSCO | International Organization of Securities Commission |
| Members | Shareholders or unit holders |
| OSC | Ontario Securities Commission (Canada) |

| Term | Meaning in this document |
|---|---|
| PCAOB | Public Company Accounting Oversight Board (US) |
| REP 317 | Report 317 *Audit inspection program report for 2011–12*, released by ASIC in December 2012 |
| RG 228 (for example) | An ASIC regulatory guide (in this example numbered 228) |
| s210 (for example) | A section of the Corporations Act (in this example numbered 210) |
| SEC | Securities and Exchange Commission (US) |
| SFC | Securities and Futures Commission (Hong Kong) |
| SGX | Singapore Exchange Limited |
| Sino-Forest | Sino-Forest Corporation |
| TSX | Toronto Stock Exchange (Canada) |
| TSXV | TSX Venture Exchange (Canada) |

# Related information

## Headnotes

back-door listings, conflicts of interest, corporate governance, disclosure, emerging markets, emerging market issuers, financial reporting, internal controls and risk management, listing rules, overseas jurisdictions, overseas regulators, related party transactions, reverse mergers

## Regulatory guides

RG 76 *Related party transactions*

RG 228 *Prospectuses: Effective disclosure for retail investors*

## Legislation

Corporations Act, Ch 2E, s201A, 210, 674, 710, 1041H

## Cases

*In re Puda Coal, Inc. Stockholders Litigation*

## Reports

REP 317 *Audit inspection program report for 2011–12*

## ASX documents

*ASX: An international centre for resources capital*, brochure, 2010

ASX Listing Rules, Chapters 4, 10 and 11, Listing Rules 1.17, 3.1, 10.1, 10.11 and 11.1.3

ASX Principles and Recommendations, *Principle 7: Recognise and manage risk*

*Proposed changes to ASX Listing Rules and Guidance Note 9*, consultation paper, August 2013

GN 1 *Applying for admission and quotation*

GN 4 *Foreign entities*

GN 5 *Chess Depositary Interests*

GN 8 *Continuous disclosure: Listing Rules 3.1–3.1B*

GN 9 *Disclosure of corporate governance practices*

GN 12 *Significant changes to activities*

## Other documents

ASIC, 'Emerging market companies: Companies operating in emerging markets', webpage, www.moneysmart.gov.au

Australian Government, *Australia in the Asian century*, white paper, October 2012

FSA, Consultation Paper 12/2 *Amendments to the listing rules, prospectus rules, disclosure rules and transparency rules*, January 2012

KPMG, *Corporate governance for small and mid-tier energy and resource companies*, survey report, August 2013

OSC, OSC Staff Notice 51-719 *Emerging markets issuer review*, March 2012

OSC, OSC Staff Notice 51-720 *Issuer guide for companies operating in emerging markets*, November 2012

PCAOB, *Investor protection through audit oversight*, statement, September 2012

SEC, *Investor bulletin on reverse mergers*, June 2011

SEC, *SEC approves new rules to toughen listing standards for reverse merger companies*, press release, 9 November 2011

TSX/TSXV, *Consultation paper on emerging market issuers*, December 2012

# Appendix 1: Reviews by overseas regulators

## Canada

109 In Canada, the OSC, TSX, TSXV and the Canadian Public Accountability Board (CPAB) have all undertaken a review of practices and rules relating to emerging market issuers.

110 The key driver behind the work conducted by the OSC and TSX appears to be the high-profile collapse of Sino-Forest, a TSX-listed company whose business was the ownership of tree plantations in China. Sino-Forest had obtained a listing on TSX by way of a reverse merger in 1995 and within 15 years had achieved a market capitalisation of C$6 billion in 2011 before filing for bankruptcy in 2012. It is alleged that Sino-Forest had been fraudulently inflating its assets and earnings. The company is now the subject of several investigations and class actions.

111 The OSC comprehensively reviewed a sample of 24 issuers whose 'mind and management' were largely outside of Canada and whose principal active operations were also outside of Canada, in regions such as Asia, Africa, South America and Eastern Europe. This represented half of the emerging market issuers over which the OSC had principal regulatory responsibility and that were listed on Canadian exchanges. The review involved an examination of the public disclosure of each selected emerging market issuer and an examination of the entity's board and audit committee activities, together with the working files of the auditors of the emerging market issuers.

112 OSC Staff Notice 51-719 *Emerging markets issuer review* summarises the review and identifies four principal concerns:

(a) the level of emerging market issuer governance and disclosure;

(b) the adequacy of the audit function for an emerging market issuer's annual financial statements;

(c) the adequacy of the due diligence process conducted by underwriters in offerings of securities by emerging market issuers; and

(d) the nature of the exchange listing approval process.[19]

113 In addition, the OSC published an issuer guide, OSC Staff Notice 51-720 *Issuer guide for companies operating in emerging markets*, to provide

[19] OSC, OSC Staff Notice 51-719 *Emerging markets issuer review*, March 2012, http://www.osc.gov.on.ca/documents/en/Securities-Category5/sn_20120320_51-719_emerging-markets.pdf.

assistance to emerging market issuers and their directors and management on their governance and disclosure practices.[20]

114 In December 2012, TSX and TSXV issued a joint consultation paper on emerging market issuers, which included proposals such as issuing guidelines to TSX participants and potentially revising TSXV's listing rules with specific requirements for emerging market issuers.[21] TSX is considering issuing guidelines, whereas TSXV is considering a more prescriptive approach. The consultation period closed at the end of February 2013 and results have not yet been published.

115 The CPAB issued a special report in February 2012, outlining significant findings and recommendations after its review of audit files for Canadian public companies whose primary operations were based in China. Overall, CPAB was disappointed by the results of its review and noted that, in too many instances, auditors did not properly apply procedures that would be considered fundamental in Canada, such as maintaining control over the confirmation process.

## United States

116 In the United States, emerging market issuers have been considered by the SEC, the Public Company Accounting Oversight Board (PCAOB) and in private litigation.

### SEC

117 From the latter part of 2010, alleged financial frauds and serious accounting issues were revealed at a number of smaller listed entities that had been subject to reverse mergers by entities incorporated in emerging markets. As at September 2012, 67 foreign-based issuers had their auditor resign, and 126 issuers were either delisted from US securities exchanges or had 'gone dark'[22]—meaning that they were no longer filing current reports with the SEC. These 126 entities included a number of companies that were formed by reverse mergers, many of which had operations in China.

118 In June 2011, the SEC issued an investor bulletin warning investors about companies that engage in reverse mergers, and detailed several enforcement actions that had been taken arising out of inaccuracies in public filings

[20] OSC, OSC Staff Notice 51-720 *Issuer guide for companies operating in emerging markets*, November 2012, http://www.osc.gov.on.ca/documents/en/Securities-Category5/sn_20121109_51-720_issuer-guide.pdf.
[21] **Error! Hyperlink reference not valid.**TSX/TSXV, *Consultation paper on emerging market issuers*, December 2012, http://tmx.com/en/pdf/Joint-Consultation-Paper.pdf.
[22] PCAOB, *Investor protection through audit oversight*, statement, September 2012, http://pcaobus.org/News/Speech/Pages/09212012_FergusonCalState.aspx.

including accounts.[23] The bulletin highlighted the risks of investing in these entities, including the risk that these entities may appoint smaller audit firms that do not have sufficient expertise and resources to substantially meet audit obligations when the company's operations are primarily located offshore.

119 In November 2011, the SEC approved amendments to the listing rules of US securities exchanges Nasdaq, New York Stock Exchange (NYSE) and NYSE Amex LLC (now NYSE MKT), which imposed new requirements on operating companies going public by completing reverse mergers with SEC-reporting shell companies.[24] In their proposals, the exchanges referred to widespread allegations of fraudulent behaviour by reverse merger companies leading to concerns that their financial statements could not be relied on.

120 Under the new listing rules, a reverse merger company will be eligible to list on an exchange only if it satisfies certain requirements. These include trading for at least one year in the US over-the-counter market, or on another regulated US or foreign exchange, maintaining a closing stock price above prescribed limits, and filing all required periodic financial reports with the SEC or other regulatory authority within statutory timeframes.

## PCAOB

121 The PCAOB, like the CPAB, has statutory backing to compel the production of audit working papers and other audit evidence to perform its surveillance and investigation function. This extends to the work of component auditors engaged by the auditor under PCAOB oversight.

122 The PCAOB has encountered concern from some jurisdictions relating to the production of books and working papers by component auditors. This is of concern to the PCAOB in its audit inspection process. It is continuing to engage with overseas regulators to try to find a workable solution.

123 In October 2011, the PCAOB proposed amendments to auditing standards that would require audit reports to disclose the name of the audit engagement partner as well as the identity of other independent audit firms or persons that provided 3% or more of the total hours in the most recent audit.[25]

124 At the time of publication of this report, these proposals are still under consideration.

---

[23] SEC, *Investor bulletin on reverse mergers*, June 2011, http://www.sec.gov/investor/alerts/reversemergers.pdf.
[24] SEC, *SEC approves new rules to toughen listing standards for reverse merger companies*, press release, 9 November 2011, http://www.sec.gov/news/press/2011/2011-235.htm.
[25] PCAOB, *Investor protection through audit oversight*, statement, September 2012, http://pcaobus.org/News/Speech/Pages/09212012_FergusonCalState.aspx.

### Private litigation

125 The decision in February 2013 of *In re Puda Coal, Inc. Stockholders Litigation* was viewed as a strong warning to outside (or independent) directors, particularly those serving at companies whose primary operations were in foreign, less-developed countries. Puda Coal, Inc.—a foreign incorporated company whose former executives were charged with fraud by the SEC for allegedly stealing and selling the company's assets before raising more than $100 million from public investors in the United States—was subject to a shareholder derivative action filed in the Delaware Court of Chancery. The plaintiff shareholders claimed that 18 months had passed before the board of directors determined that most of the company's assets located offshore had been stolen by the foreign-based chairman.

126 The court held that the US-based independent directors of the company breached their fiduciary duty of loyalty by failing to discharge their oversight function—noting that:

> Independent directors who step into these situations involving essentially the fiduciary oversight of assets in other parts of the world have a duty not to be dummy directors.

## United Kingdom

127 The concept of emerging market issuers does not appear to have been specifically considered at this time in the United Kingdom.

128 However, in January 2012, the Financial Services Authority (FSA)—now the Financial Conduct Authority (FCA)—released Consultation Paper 12/2 *Amendments to the listing rules, prospectus rules, disclosure rules and transparency rules*.[26] This consultation paper set out a number of proposed changes, including the introduction of rules for externally managed companies.

129 'Externally managed companies' are special-purpose acquisition companies, newly incorporated offshore with the intention of acquiring, running and transforming target companies whose management functions are significantly outsourced to offshore advisory firms.

130 The boards of these entities are comprised of non-executive directors who have been recruited by the founders of the firm. These founders form an offshore advisory firm, which signs a contract with the listed company to provide advice. The advisory firm seems to be solely incorporated to provide advice to the newly listed company.

[26] FSA, Consultation Paper 12/2 *Amendments to the listing rules, prospectus rules, disclosure rules and transparency rules*, January 2012, http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/cp/cp12_02.pdf.

131 Both the listed company and the advisory firm are generally incorporated in a tax haven.

132 The effect of the advisory arrangement is that the listed entity employs no staff itself, and has an exclusively non-executive board. It is the role of the advisory firm to identify acquisition targets and manage their integration into the listed company business. The motivation for this structure appears to be tax minimisation.

133 The FSA made two proposals to address the governance and disclosure concerns they had identified. Following consultation in October 2012, two proposals were implemented in the rules.

134 The first proposal was to revise the prospectus rules, disclosure rules and transparency rules to make the principals of the advisory firm responsible for any prospectus published by the listed company, and to clarify that they are likely to be subject to rules on the disclosure of share dealings in the listed company's shares. The disclosure rules and transparency rules were also amended to include a new rule clarifying that a person discharging managerial responsibility (or a senior executive) of the listed entity is not restricted to those with a director's service contract or to employees of the listed entity.

135 The second proposal was to revise the listing rules to restrict externally managed companies from becoming premium listed, or if they are already premium listed, unwinding this status. A transitional period until 31 December 2013 to unwind existing premium listings was permitted by the FSA. This will exclude externally managed companies from participation on the FTSE 100 Index of the London Stock Exchange.

## Singapore

136 In July 2012, Singapore Exchange Limited (SGX) announced revisions to its listing requirements in the Mainboard Rules. The changes were introduced to distinguish more clearly between the larger and more established companies on the SGX Mainboard and the fast-growing companies on SGX Catalist. Singapore's market had progressed since the Mainboard admission criteria were previously revised in 1999, and Catalist was therefore introduced as a listing platform for fast-growing companies in 2008. Together, the Mainboard and Catalist listing platforms cater for a broad continuum of companies of varying size, track record and maturity seeking to access funding from the equity market. The distinction serves to facilitate investment strategies and help fund managers in the tailoring of investment portfolios.

137 These changes occurred shortly after Singapore experienced a series of accounting scandals involving small foreign audit firms. One such example was KXD Digital Entertainment Limited, where breaches uncovered by the

auditor included the company failing to announce that it had ceased all of its business operations and converted to a cash company. It had also not disclosed that Koninklijke Philips Electronics NV had filed and won by default a number of lawsuits against the company in 2007–08.

138 The main change to the Mainboard Rules was the introduction of Rule 210(2), which deals with quantitative listing admission criteria. With effect from 10 August 2012, an SGX listing applicant is required to satisfy one of the following quantitative requirements:

(a) to have a minimum consolidated pre-tax profit of at least S$30 million for the latest financial year, and an operating track record for at least three years;

(b) to be profitable in the latest financial year, have an operating track record of at least three years, and have a market capitalisation at initial public offering of not less than S$150 million; or

(c) to have generated operating revenue in the latest completed financial year, and have a market capitalisation of not less than S$300 million.

## Hong Kong

139 Hong Kong differs to Australia in that most companies listed on the Hong Kong Stock Exchange (HKEx) are not incorporated there. Before British handover in 1997, many Hong Kong entities re-domiciled in the Cayman Islands or Bermuda. Entities domiciled in these jurisdictions are generally considered to offer equivalent shareholder protection to that offered in Hong Kong.

140 In 2007, the Securities and Futures Commission (SFC) and HKEx made a joint policy statement about the listing of overseas companies. This policy statement clarified that HKEx did not restrict listing applications to entities domiciled in Bermuda, the Cayman Islands or China. Rather, any overseas company could apply for listing if it addressed a schedule of shareholder protection matters to HKEx's satisfaction. One of these matters is whether the overseas jurisdiction has adequate arrangements with the SFC for mutual assistance and exchange of information to enforce and secure compliance with the laws and regulations of that jurisdiction and Hong Kong.

141 Back-door listings or reverse mergers are an area of interest in Hong Kong. The HKEx Listing Rules have provisions that regulate reverse mergers and operate to limit the ability of companies to circumvent the initial listing requirements. The listing rules also contain provisions on material acquisitions, to protect shareholders by requiring shareholder approval and detailed disclosure on the company acquiring the listed entity. This includes the preparation of an accountant's report.

# Appendix 2: Regulatory framework in Australia

## Corporations Act

142 All entities incorporated in Australia must comply with the Corporations Act. Companies not incorporated in Australia have to comply with some of the provisions of the Corporations Act. Some key aspects for compliance by emerging market issuers are set out below.

### Capital raising

143 All public securities offerings, whether or not the entity is incorporated in Australia, must be conducted under a disclosure document (usually a prospectus), unless an exemption applies. There are no specific exclusions or restrictions imposed on companies incorporated overseas for raising capital in Australia, if they abide by these requirements.

144 The broad principle-based disclosure test in s710 of the Corporations Act, imposed on issuers preparing a prospectus, requires disclosure of the business model and risks associated with an entity's operations, including its emerging market operations if these are material.

### Financial reporting

145 All entities incorporated in Australia that offer securities to the public are generally required to prepare yearly and half-yearly financial statements in accordance with Australian accounting standards (which are based on International Financial Reporting Standards (IFRS)). Entities incorporated outside Australia are required, if carrying on business in Australia, to be registered with ASIC and lodge with us the financial statements they are required to prepare under their home jurisdiction. In some cases, a balance sheet, profit and loss statement and cash flow information may be required to be prepared in Australia if these are not covered by the financial statements that the company must prepare under the laws of its home jurisdiction.

### Corporate governance

146 Many of the provisions in the Corporations Act on directors' duties and other governance issues apply only to companies incorporated in Australia. These include related party transactions. It is worth noting that s201A of the Corporations requires that there must be at least two directors ordinarily resident in Australia for an Australian entity.

### Misleading or deceptive conduct

147 The general prohibitions on misleading or deceptive conduct, set out in the Corporations Act, apply to all listed companies, whether or not they are incorporated in Australia. Under the Act, any person in this jurisdiction must not engage in conduct, in relation to a financial product or financial service, that is misleading or deceptive, or is likely to mislead or deceive. This is widely defined to include dealing in a financial product, issuing a financial product, making a takeover bid or a recommendation in relation to a takeover bid, or doing any act preparatory to or related to dealing in or issuing a financial product or making a takeover bid: s1041H. A breach of this provision is not an offence but exposes the person or company to civil penalty proceedings.

### Continuous disclosure

148 The continuous disclosure provisions contained in s674 of the Corporations Act apply to all entities listed on ASX and other Australian financial markets regardless of their place of incorporation, unless the entity is listed on ASX as a foreign exempt entity (see regulation 1.2A.01).

### Takeovers

149 Where an entity is incorporated outside Australia, it is the takeover provisions of the overseas jurisdiction that apply in relation to control transactions. This means that members in a foreign incorporated entity may have fewer protections in relation to who controls the entity. The Australian takeover laws only apply to Australian entities.

## ASX Listing Rules

150 Because much of the Corporations Act does not apply to entities incorporated outside Australia, a market's listing rules (in this case, the ASX Listing Rules) have a key role to play in ensuring that the information received by investors from foreign incorporated entities is sufficient and there is sufficient shareholder accountability.

151 In this respect, the following key provisions of the ASX Listing Rules are worth highlighting.

### Applying for admission and quotation, and auditor competence

152 ASX has recently made some changes to its guidance notes, which directly affect the emerging market issuer population.

153 For example, a revision to ASX Guidance Note 1 *Applying for admission and quotation* (GN 1) states that, in certain cases, ASX may require the disclosure of additional information under ASX Listing Rule 1.17 about the qualifications and experience of the auditor of an entity applying for admission to the official list of ASX, and of the accountants and auditors who prepared, audited or reviewed the financial documents provided as part of the admission process (e.g. to verify compliance with the profit test or assets test).

154 This change has arisen from concern surrounding the competence and qualifications of some auditors reviewing accounts of entities seeking admission to the list. ASX has found that some proposed auditors do not have sufficient resources or experience to be the auditor of an ASX-listed entity.

## Chess Depositary Interests

155 ASX Guidance Note 5 *Chess Depositary Interests* (GN 5) sets out ASX's approach to Chess Depositary Interests (CDIs) and the listing rules that foreign issuers must adhere to. CDIs can be used for any securities of a foreign company (including an ASX Exempt Foreign Listing) incorporated in a jurisdiction whose laws do not recognise electronic security holdings and/or electronic transfers. They can be used for either debt or equity securities. CDIs can be converted into shares in an overseas jurisdiction on election by the CDI holder.

## Specific disclosure by foreign entities

156 ASX Guidance Note 4 *Foreign entities* (GN 4) was amended to include guidance on certain disclosures that ASX will generally want to see in the listing prospectus or Product Disclosure Statement of a foreign entity. These include:

(a) the place of incorporation;

(b) the following statement:

> As [name of entity] is not established in Australia, its general corporate activities (apart from any offering of securities in Australia) are not regulated by the *Corporations Act 2001* of the Commonwealth of Australia or by the Australian Securities and Investments Commission but instead are regulated by [insert name of governing legislation] and [insert name of corporate regulator administering that legislation]; and

(c) a concise summary of the rights and obligations of security holders under the law of its home jurisdiction, including how the disclosure of substantial holdings and takeovers are regulated.

157 The approach ASX has taken in GN 4 is consistent with the requirements adopted in other overseas jurisdictions.

## Continuous disclosure

158 ASX Listing Rule 3.1 applies to all entities other than ASX Exempt Foreign Listings. It requires that, once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.

159 There is an exception under ASX Listing Rule 3.1A, which means that ASX Listing Rule 3.1 does not apply in the following circumstances:

(a) if one or more of the following five situations applies:

(i) it would be a breach of the law to disclose the information;

(ii) the information concerns an incomplete proposal or negotiation;

(iii) the information comprises matters of supposition or is insufficiently definite to warrant disclosure;

(iv) the information is generated for the internal management purposes of the entity; or

(v) the information is a trade secret;

(b) if the information is confidential and ASX has not formed the view that the information has ceased to be confidential; and

(c) if a reasonable person would not expect the information to be disclosed.

160 How these rules apply is explained in ASX Guidance Note 8 *Continuous disclosure: Listing Rules 3.1–3.1B* (GN 8).

## Corporate governance

161 ASX Guidance Note 9 *Disclosure of corporate governance practices* (GN 9) has been published to assist listed entities to comply with ASX Listing Rule 4.10.3. This rule, as it is presently written, requires an entity to include in its annual report a statement about the extent to which it has adopted the recommendations of the ASX Corporate Governance Council in that financial year. GN 9 is presently subject to public consultation, including where this information should be disclosed.[27]

162 It is important to note that GN 9 and ASX Listing Rule 4.10.3 require disclosure of these matters, but it is not ASX's role to pass judgement on the quality or effectiveness of the policies and practices adopted by a company. ASX's role is to ensure that a listed entity meets the disclosure requirements.

163 Accordingly, it is the responsibility of the board of an entity to assess the appropriateness of the policies and procedures adopted. Members can then

[27] On 16 August 2013, ASX released for public comment a consultation paper, *Proposed changes to ASX Listing Rules and Guidance Note 9*, http://www.asxgroup.com.au/media/PDFs/asx-governance-consultation-paper.pdf.

assess this disclosure and form a view on the appropriateness of the corporate governance approach of the entity, and exercise their voting power.

## Related party transactions

164 Chapter 10 of the ASX Listing Rules imposes a requirement that, where a transaction or benefit with a related party or a subsidiary exceeds the value of 5% of the issued capital of the entity, it must be put to members for their approval.

## Significant transactions that change the nature or scale of activities

165 Chapter 11 of the ASX Listing Rules sets out the requirements that an entity must satisfy if it proposes a significant change to its activities or floats significant assets. It may be that, as a result of the change, ASX requires the entity to meet the requirements in Chapters 1 and 2 of the ASX Listing Rules as if the entity were applying for admission to the official list.

166 ASX Guidance Note 12 *Significant changes to activities* (GN 12) explains how ASX applies Chapter 11 of the ASX Listing Rules to determine whether a significant change in the nature or scale of activities has occurred.

167 It also sets out ASX's policy on back-door listings, particularly that it will exercise its discretion under ASX Listing Rule 11.1.3 to require a listed entity facilitating a back-door listing to re-comply with the admission requirements. This is based on the principle that a person seeking to have operations or assets listed should not be able to achieve by the back door what they cannot achieve through a conventional initial public offering.

## Financial reporting

168 Chapter 4 of the ASX Listing Rules sets out an entity's obligations to periodically report to ASX. Even if an entity is not incorporated in Australia, the ASX Listing Rules require that, where a foreign entity is required under the laws of its home jurisdiction to prepare an annual report for members, this document must be given to ASX within the timeframes required in its home jurisdiction.