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By email: jonathan.coultas@asic.gov.au

Dear Mr. Coultas

ASIC CONSULTATION PAPER CP 118 " RESPONSIBLE HANDLING OF RUMOURS" - SUBMISSION BY STOCKBROKERS ASSOCIATION OF AUSTRALIA

Introduction

As you would be aware, the Stockbrokers Association of Australia ("Stockbrokers Association") was formerly known as the Securities & Derivatives Industry Association (SDIA), the change of name having recently taken place on 29 October 2009. The Stockbrokers Association is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. The Stockbrokers Association is pleased to provide this submission to ASIC in relation to Consultation Paper CP 118 "Responsible Handling of Rumours".

The Stockbrokers Association's members have a strong commitment to maintaining the integrity and high standing of Australia's securities market.

Ensuring the wide and equal dissemination of price sensitive information is fundamental to an efficient market. However, the spreading of false or misleading rumours about listed securities has the potential to be highly damaging to the efficiency and integrity of the market generally, and to the individual securities affected. False information distorts the price of securities and can facilitate "pumping and dumping", and "runs" on securities

The speculation and reports of the instances of rumourtrage during the recent financial crisis are an example of the volatility and potential damage that can flow from the circulation of false and misleading rumours.

The Stockbrokers Association commends ASIC for dealing with this important and difficult subject area. In particular, the Stockbrokers Association supports the approach ASIC has taken in addressing the subject by means of Best Practice Guidelines, and not by means of recommending further legislative changes. The Stockbrokers Association in its submission to CAMAC in relation to its recent *Review of Aspects of Market Integrity* argued that the existing market manipulation and prohibited conduct provisions in the Corporations Act contained sufficiently strong remedies to deal with the false and misleading statements with respect to securities, and the practice known as "rumourtrage". ASIC's approach is consistent with this and with the recommendations in the CAMAC Report.

However, whilst the Stockbrokers Association supports the overall approach embodied in the Guidelines, some of the proposed requirements are in our submission not workable in practice and/or create an administrative burden which is too onerous.

Specific Questions

B1. Definitions

B1Q1 Do you agree with this definition of rumour in the context of its proposed application in our guidance? If not, why not?

The definition of "rumour" in CP118 is in our view appropriate. It appears to be consistent with the definition employed in equivalent overseas jurisdictions.

We support the exclusion of opinions from the scope of the definition, as appropriately formed and qualified opinions are fundamental to the operation of the market.

B1Q2 Are there particular aspects of this definition that you feel require particular guidance?

Please see the answer to C1Q1 below in relation to "widely circulated".

B1Q3 Do you think there should be a specific carve-out for opinions? If so, how would you deal with an opinion where the speaker has no knowledge on which to base an opinion?

See answer to B1Q1 above. The existing legislation deals adequately with opinions.

C1. Proposed Principles

C1Q1 Do you agree with these proposed principles? If not, why not?

The Stockbrokers Association broadly supports the proposed Principles in CP118, subject to the comments below.

The Stockbrokers Association supports the requirement that licensees have appropriate written policies and procedures in place dealing with the handling of rumours.

The prohibition on the initiation of rumours is in our view unarguable.

However, the requirement set out in (a) (ii), namely, that "*…a rumour may only be communicated if it is already 'widely circulated' and it is reasonable to pass it on, given all the circumstances* " is in our view unworkable in practice. Firstly, it is not at all clear what "widely circulated" means. Secondly, even if it was clear, it is difficult to see how one can easily determine whether this is the case in practice.

If a dealer is told a rumour, say by a client, in a telephone conversation, how is the dealer to ascertain whether the rumour is widely circulated? If the dealer is told that there are 5 other people that the client is aware knows the rumour, is that sufficient? If the dealer is aware that another dealer in the firm has also heard the rumour as well, is this sufficient?

Other than for rumours that are published in the major newspapers or on radio/television, it is difficult to see how one could establish with any certainty whether or not a rumour was "*widely circulated"*, which would mean that effectively no rumours at all could be discussed, even where that rumour might be relevant to explaining market activity, other than when the rumour had been mentioned in the news.

It is also difficult in our view to see how any person could safely make a determination that the communication of a rumour would "*not unduly distort the market"*. How markets react to rumours will depend on a multitude of factors, and the reactions of a wide variety of different individuals, institutions and investors. A rumour may well undergo a number of permutations or embellishments, so it would be an impossible task to require a person to form a view of the likely market reaction to a rumour before it is circulated.

As mentioned, the Stockbrokers Association does not support the circulation of false and misleading information in relation to securities. However, there will be occasions where mentioning a rumour may be reasonable in the circumstances, even if the rumour has not been reported in the press. This appears to be acknowledged in paragraph [58] of CP 118. Clients will not uncommonly ask their broker if they have any idea why stock XYZ has "gone for a run today " etc, when there has been no obvious reason. Clients will have an expectation that their broker will tell them what the broker knows, subject of course to legal obligations such as insider trading and confidentiality. If the broker believes that the rumour may be impacting on the market for the security, then the broker, under its duty to advise the client of all relevant information, will have an obligation to their client to advise them of this.

If the broker has heard from a number of sources that a rumour is out in the market, then under the proposed guidelines, the broker would probably be precluded from letting the client know of the rumour in order to explain the market (or the "market colour") even if the broker were to appropriately qualify it as a rumour and unsubstantiated, because of the issue of not knowing how to be satisfied that the rumour was *"widely circulated"* . There would be many who would see this as going too far.

We note that FINRA in the US has proposed a permissible exception for:

> *"…discussions of rumours among market participants when necessary to explain market or trading conditions and one's view of the validity of the information, provided the communication is not intended to influence the price movement of a security and the information is communicated in a responsible way (i.e. sourcing the information where possible, but not embellishing the information, and presenting the information in as neutral and balanced way as practicable in the circumstances)." [see FINRA Regulatory Notice 09-29 p.3]*

The Stockbrokers Association considers that this approach has a great deal to commend it. It is a formulation for the responsible handling of a rumour (rather than preventing the handling of a rumour). This approach would be preferable in our view to the highly prescriptive and bureaucratic administrative framework for logging and considering rumours detailed in Table 3 (see C.2 below).

We do not see any reason to restrict the exception to discussions between "market participants", unless that term is taken to include clients. In our view, there is no reason why discussions handled in the manner outlined could also not properly take place with clients.

Training. The Stockbrokers Association strongly supports the requirement for formal training on rumour handling. In our view, the key to effectively addressing appropriate conduct on this difficult subject is to ensure that staff are properly trained, including appropriate refresher training at regular intervals.

Monitoring. It will ordinarily follow that a licensee should have in place an appropriate monitoring program in relation to its various obligations and procedures. The more basic issue relates to the nature and detail of what should be in the policies and procedures, and hence what should be monitored. In this respect, we refer to our answers to the Question in section C2 below.

C1Q2 Are there any other principles that should be included?

No.

C1Q3 What additional costs might be associated with implementing these principles? Can you quantify such costs?

The level of documentary and procedural detail that is set out in the proposals is very high, which would necessarily mean that the administration of the proposed arrangements will be very expensive and will involve a high level of resourcing, particularly at a senior level.

In particular, we note the following

- The various determinations whether a rumour was "widely circulated", whether it would not "unduly distort the market", and whether discussion was reasonable in the circumstances, are required at a senior level. The time involved in managerial oversight of the various determinations would be a significant diversion of management attention from other important tasks, and will potentially require costly addition to staffing resources.

- The process for attempting to verify the rumour with the company concerned. Such communications with listed entities would again need to occur at a senior level. There will be also be much duplication across the market, as it is likely that multiple such communications with the listed entity would occur as more than one licence holder becomes aware of a rumour. It is questionable whether such a communication will achieve anything, as listed entities will commonly have a policy of not commenting on rumours.

- The requirement for documentation in writing of the various processes e.g. the attempts to verify the information, the basis of determining that further discussion was reasonable, etc, will be time consuming.

It is impossible to quantify these costs in dollar terms, however on the basis that there are likely to be a great many pieces of information that will need to be dealt with in this way, we would estimate that the cost will be considerable.

C2. Proposed Policies and Procedures - TABLE 3

C2Q1 Do you agree with the proposed policies and procedures? If not, why not?

The three issues specified under the Guidance, on which a view is required to be formed, are for the reasons set out above, extremely difficult to determine, namely

- Whether the rumour is in wide circulation
- The likely impact of the rumour on the market price of a security
- Whether circulation would unduly distort the market.

As mentioned in C1 Q3 above, the requirements relating to the recording of rumours in a log are unnecessary, and generate an administrative burden which is unworkable and costly. For the same reasons, requiring a senior person in the firm to make a determination in each case in relation to communicating the rumour is unworkable and potentially quite expensive.

These requirements will apply to every rumour that is heard on any given day, across all dealing desks, and also to every rumour that may be published in the daily press and news broadcasts. This could easily involve a great many items that would need to be processed, logged and determined in accordance with the Proposed Requirements. The burden and costs involved in the case of a firm with large number of dealers could potentially be major. In the course of the year, there could be many hundreds of pieces of information that could potentially constitute a "rumour" and therefore require to be logged under the proposed arrangements.

The Stockbrokers Association would also question the extent to which the proposed arrangements, focusing entirely on the holders of AFS licences, are likely to achieve ASIC's objectives of eliminating rumours. Given the wide range of other parties who have the potential to be the origin of rumours and or the potential to circulate them e.g. parties close to listed issuers, internet chat sites, investor clubs, investor newsletter publishers, etc., and who would not hold be the holders of an AFS licence, then the extent to which the proposals in CP 118 will deliver a significant benefit are open to question, and the imposition of a significant cost burden onto AFSL holders alone in those circumstances would be an undue burden.

We do not agree with the suggestion in CP 118 that the creation of a log will have the benefit of raising awareness about rumours or will assist staff to better able to distinguish between rumour and opinion (see [54] and [55]). In the Stockbrokers Association's view, appropriate training will deliver those objectives, however the onerous record keeping obligations are not likely to. All that the log is likely to achieve will be a record of rumours heard on a daily basis by each firm (assuming full compliance with the obligations), compiled at significant cost and disruption to the firm's business.

C2Q2 Are there any other policies or procedures that should be included apart from those listed in Table 3?

No.

C2Q3 To what extent do AFS licensees' current practices reflect these procedures?

It is difficult to generalize as to the extent to which licensees' current practices reflect all of the procedures proposed in CP 118. However, the Stockbrokers Association is not aware of any licensee who currently keeps a log of rumours in the manner proposed. We also are not aware of any licensee who has adopted a standing requirement to form an assessment of the three matters referred to under Guidance in Table 3.

C2Q4 What additional costs might be associated with this proposal? Can you quantify such costs?

Please see answer to C1 Q3 above.

C2Q5 Do you agree that a process for recording rumours is an important part of the compliance process? Is it an undue cost burden?

As indicated above, the Stockbrokers Association does not support the recording requirements and does not believe that it achieves the objectives foreshadowed in CP118. The cost burden is likely to be considerable, for no corresponding benefit.

Conclusion

Whilst CP 118 has been a good first step in addressing the question of circulation of rumours in the market, the Stockbrokers Association believes that a far more effective way of achieving ASIC's objectives would be for the Guidelines to be re-shaped to focus more on the appropriate manner in which a rumour which is in existence in the market should be communicated where appropriate e.g. with the appropriate caveat that it is a rumour and has not been verified, and on a requirement for comprehensive training for employees on the provisions already set out in the Corporations Act, rather than on laying down a bureaucratic set of procedures that are likely to be costly and a nightmare to implement, and with dubious prospects of actually addressing the issue.

We would be happy to discuss any issues relating to this matter at your convenience. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au .

Yours sincerely,

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