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Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
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By email: camac@camac.gov.au

Dear Mr Kluver

SUBMISSION ON CAMAC ISSUES PAPER- ASPECTS OF MARKET INTEGRITY

Introduction

The Securities & Derivatives Industry Association (SDIA) is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. It has 66 members accounting for 98% of market turnover by value. SDIA is pleased to provide this submission to the Companies and Markets Advisory Committee (CAMAC) on its Issues Paper "Aspects of Market Integrity" (referred to hereafter as "the Issues Paper").

SDIA's members have a strong commitment to maintaining the integrity and high standing of Australia's securities market. SDIA commends the Minister's referral of the matters in the Issues paper for review by CAMAC. It is important that close consideration be given to matters that have the potential to impact adversely on the integrity of Australia's financial markets.

This Submission addresses Sections 3 and 4 of the Issues Paper, namely, Spreading False or Misleading Information and Corporate Briefings to Analysts.

SDIA does not make any submissions relating to the other two sections, namely Margin Lending to Directors and Blackout Trading by Company Directors.

Spreading False or Misleading Information

We refer to the Issues for Consideration set out for Comment in the Issues Paper:-

Initiating rumours (Section 3.3)
(1) the implications for market integrity of rumour-mongering
(2) should all or some of ss 1041E, 1041F and 1041G be civil penalty provisions as well as attracting criminal liability
(3) should any of the elements of any of these three provisions be amended and, if so, in what manner
(4) should some form of compulsory recording of telephone conversations and other electronic forms of communication, such as SMS, be introduced
(5) any other steps to facilitate the detection and prosecution of rumour-mongering
Target response to rumours (Section 3.4)
(6) would there be benefit in ASIC or the ASX providing further guidance on how companies should deal with market rumours affecting their securities
(7) in that context, would it be beneficial to adopt any of the principles in the FSA Market Abuse Directive Instrument
Recipients of rumours (Section 3.5)
(8) would it be beneficial to develop best practice guidelines on how to deal with rumours received
(9) if so, what should be the content of those guidelines, who should develop them and how should they be monitored or enforced?

It is important to make clear at the outset that "rumour mongering" is taken to refer to the circulation of rumours which are either false or misleading, whether deliberately or recklessly, or which may be materially price sensitive, as opposed to merely passing on rumours as such that have been heard in the market.

It is difficult to prevent people talking about rumours. It is an inherent part of human nature. It is unlikely that legislation would ever be effective to prevent people engaging in gossip and passing on rumours generally. As far as the markets are concerned, gossip and rumours are regarded as part of market "colour". A client who is discussing a stock with their broker will consider the broker duty-bound to tell them everything they have heard about the stock, within the bounds of legal obligations, and not withhold information from them.

The focus of legislation and guidelines should be (as it currently is) on prohibiting the dissemination of rumours which are false or misleading, either knowingly or recklessly, or which may be materially price sensitive and where the rumour has some credibility e.g as a result of knowing the source of the rumour.

Notwithstanding the recent coining of the term "rumourtrage" and the allegations of that the practice has been widespread in recent months, the spreading of false or misleading information regarding securities is not a new phenomenon. The classic case of R v De Berenger, often referred to in legal texts, involving the individuals who dressed in military uniform and spread false reports that Napoleon had been killed in battle and that Wellington had reached Paris, in order to profit from the inevitable rise in the market for government securities, is an excellent example in distant history.

Existing legislation adequate. The prohibitions currently in the Corporations Act have evolved over time to address such practices, both specifically and generally. The various sections are cited in the Issues Paper, including sections 1041A-G.

In SDIA's view, the existing legislation provide a formidable arsenal to the regulator to deal with market manipulation generally, and rumourtrage/false and misleading statements in particular, and there is no pressing need to change the laws. There have been a number of cases over the years where instances of market manipulation have been the subject of successful enforcement action by ASIC and by ASX in cases of quite complex market scenarios, indicating that the legislation can be quite effective. Significant fines have been imposed in a number of cases, indicating the robustness of the existing regime.

There is an argument that the provisions would benefit from being reviewed. The sections have been derived from various sources and have evolved in a piecemeal way over time, and there is a considerable amount of overlap between some of the sections. The sections may benefit from being reviewed to remove this overlap. However, it is important that in making any changes to streamline the sections, no new element of uncertainty is created as a result of the language that is used.

There is also no reason why sections 1041E, 1041F and 1041G should be on a different footing to the other market misconduct provisions, so we can see no grounds to argue those sections should not be made civil penalty provisions in line with the other provisions.

Better enforcement needed. In SDIA's view, what is needed is greater and more effective enforcement of the provisions that exist. ASIC needs to make

greater efforts to be closer to the markets and to employ a better market surveillance and intelligence program. In our view, if the markets perceived that ASIC was policing this area to a greater degree, then the incidence of "rumourtrage" would not be seen as so prevalent. There is evidence that the increased attention devoted by ASIC recently in response to the perceived incidence of "rumourtrage" has already had an impact on the level to which that conduct is perceived to be occurring in the market.

Mandatory telephone recording not justified. SDIA does not believe that the introduction of a mandatory requirement for brokers to tape telephone lines would make a material impact on the ability of ASIC to bring successful enforcement action. SDIA notes that the CAMAC Issues Paper quotes the UK FSA, which is about to introduce this requirement, as saying that "This requirement will have a limited effect on the detection of rumour-mongering."

There are a myriad of means of other communication available to any person who was intent on spreading false information and/or inside information, and it would not be a difficult matter to communicating with a broker using a means other than a taped telephone line.

As against this, the cost of introducing mandatory telephone taping would be considerable. Quite apart from the infrastructure costs, it is also necessary to factor in the cost of storage of the tapes for what is likely to be a considerable period of time, and the cost of retrieval to satisfy regulatory query. The total costs would be significant, and in our view will far outweigh any potential benefit. Introducing costs of this magnitude at a time when the securities industry is under severe financial pressure due to the economic downturn, and at a time when other additional compliance and IT costs are being imposed, including the costs of introduction of short sale and stock lending reporting, and additional capital requirements, would be onerous.

Therefore, SDIA believes that mandatory taping would be a disproportionate reaction to the prevailing situation.

In relation to rumours which may involve the dissemination of price sensitive information, such as where the rumour contains sufficiently definite information or where the identity of the source provides credibility to the information, this is an area where the operation of the existing insider trading provisions is widely understood. A person to whom a rumour is passed in these circumstances is potentially an insider, and would be precluded from dealing in the securities the subject of the rumour and from passing on the rumour. SDIA does not believe that any additional requirements or legislative change is needed to deal with this scenario.

On the question of the response by Targets to rumours, SDIA considers that the practice most commonly followed by target companies of not responding to rumours is the appropriate one in our view, provided that this satisfies the Target's obligations under the Continuous Disclosure regime are met. No further Guidelines for responding to rumours by Target companies is in our view necessary.

Corporate Briefings to Analysts

We refer to the Issues for Consideration set out for Comment in the Issues Paper:-

4.7 Issues for consideration
(1) the role that analysts' briefings play in Australia's financial market and the implications for market efficiency and integrity of these briefings
Public briefings
(2) whether there should be greater guidance on what is required to ensure that the information provided in a public briefing is effectively and expeditiously disclosed generally? For instance, should all public briefings be webcast and/or podcast and in either case should a transcript of the proceedings also be provided
(3) whether there are any approaches to public briefings of analysts in overseas jurisdictions that could usefully be adopted in Australia.
Private briefings
(4) whether private briefings to analysts increase market efficiency beyond what may be achieved through public briefings
(5) whether particular issues arise in relation to compliance with, and the enforcement of, the insider trading and continuous disclosure provisions, and whether, or in what manner, those issues could be dealt with through further legislative or other initiatives. In this context:
- should the equivalent of SEC Rule 100 *Selective disclosure and insider trading* be adopted
- should there be mandatory record-keeping requirements for some or all private briefings and, if so, of what nature
(6) whether there should be any restrictions on when companies can conduct private briefings, for instance by the introduction of mandatory blackout periods for non-public briefings prior to the publication of periodic financial results
(7) whether there are fairness or other equal access concerns with current practices regarding private briefings and, if so, how they might be dealt with. For instance:
- in what, if any, circumstances, would it be appropriate and feasible to require that all or part of the content of communications in private briefings to analysts be made available to investors generally, and
- if that content is to be made available, in what manner
- should the market be informed in advance of the timing of the publication of a listed company's financial results

(8) whether any issues of intellectual property rights would arise in any move to require that the content of communications in private briefings to analysts be made available to investors generally and, if so, how they might best be dealt with
(9) whether there are any approaches to private briefings of analysts in overseas jurisdictions that could usefully be adopted in Australia.

Role of Research Analysts. Research Analysts perform a vital role in the financial markets. As noted in the Minister's letter quoted in the Issues Paper, analysts keep the market informed. Research analysts critically analyse publicly available information about listed companies and issuers, including accounts and other financial information. They also critically analyse the performance of the company, its management and the company's sector.

This analysis independent of the management of the company is vital in assisting investors in assessing the true value of a company and its securities and their prospects. Only the largest of institutional investors have the resources to perform such analysis themselves. Even though research analysts generally publish their analysis only to the clients of the firm which employs them, the benefits of broker research does find its way into the market as a whole, which is to the benefit of all investors and potentially informs the share price of the security.

Therefore, we submit that the contribution of research analysts to market efficiency is beyond dispute.

Existing Regulation and Guidance Effective. We note that during the last decade, equity research has been reviewed in great detail in various jurisdictions, including in the course of the ASIC "Heard it on Grapevine" project, without any conclusions to the contrary.

We note that as a consequence of the reviews carried out at that time, various guidelines were issued, including *Better Disclosure for Investors – Guidance Rules* published by ASIC, the *Best Practice Investor Relations: Guidelines for Australasian Listed Entities* published by the Australian Investor Relations Association in May 2006 ("the *AIRA Guidelines*"), and the *Corporate Governance Principles and Recommendations* published by the ASX Corporate Governance Council. The SDIA produced guidelines for research analysts in conjunction with the Securities Institute, entitled *Best Practice Guidelines for Research Integrity*.

The above guidelines are thorough and well considered, and each resulted from a lengthy process of consideration of issues relating to the release of information

by listed companies and communications with research analysts. They are all founded on the fundamental principle that materially price sensitive information should be released to the market generally and should not first be released selectively. They contain a wealth of other guidance on best practice for issuer interaction with the market.

In SDIA's view, the question of potential selective dissemination of materially price sensitive non-public information by issuers is adequately addressed by the existing insider trading provisions of the Corporations Act in conjunction with the ASX Listing Rules (particularly L.R. 3.1 and Guidance Note 8) and as amplified by the abovementioned guidelines. We are not aware of any significant failures that have occurred in recent times that would suggest the need for amendment or addition to existing regulation.

In particular, SDIA also does not support limiting the extent to which issuers are able to communicate with investors, research analysts or financial journalists, as the need arises and in the most efficient and effective manner, whether that be on a large or small group or on a one-on-one basis.

There is in our view a widespread acceptance and implementation of the principles contained in the various Guidelines referred to. There were a limited number of instances in which selective disclosure arose as an issue in around 2002 e.g. Southcorp matter, AMP, in which subsequent remedial action was quickly taken to address the situation and the market kept informed. Since those instances, there have not been any repeat cases that have come to light. In our assessment, these instances served as an education to the market, and there is no indication that there are systematic selective disclosures of price sensitive information occurring in the market at present. If this was commonly occurring, we would have expected that a significant number of instances would be coming to light on an ongoing basis.

Role of Public and Private Briefings. We refer to the *AIRA Guidelines* to which reference is made in the Issues Paper. We note at Page 8 the *AIRA Guidelines* conveniently set out a variety of meeting activities that typically are carried out by a listed company, including media briefings, analyst briefings, media conferences, buy-side lunches, dealing room briefings and domestic/international road shows. The Guidelines also note that analyst and investor briefings may be group Briefings or one-on-one meetings.

This range of different forums of communication have clearly been developed over time to assist issuers to structure the way in which they communicate with

all relevant groups with whom they needs to communicate, and in a way which is most efficient, practical and effective to the issuer.

Whilst some of the meetings referred to are group meetings, they may in practice be meetings of only a small group e.g. of investors, dealers, and hence they are similarly selective, even though they are not one-on-one meetings.

Whilst public briefings are likely to be preferable for certain forms of meetings for practical reasons (e.g. efficient time use,) and for compliance reasons (to more conveniently monitor for the potential risk of inadvertent selective disclosure of price sensitive information), it would not make sense to limit the flexibility of issuers to communicate with either small groups or with research analysts on a one-on-one basis where needed, and to "corral" the issuer into a series of large scale meetings. This would in our view hinder communication with issuers and the flow of information to the market. An issuer should have the flexibility to hold meetings as circumstances warrant.

It is noted that the Issues Paper at 4.3 quotes sources which confirm the value that companies place on being able to hold on-on-one meetings.

It is important also from the point of view of quality of analyst research that one-on-one briefings not be prohibited. It may not be practical, feasible or efficient for the body of analysts present at a group meeting for each individual analyst to pursue their own lines of questioning within the time constraints of the meeting.

Issues may also arise in between meetings which an analyst may wish to pursue, and which cannot wait until the next group meeting. In particular, an individual analyst may identify a particular issue or line of enquiry as a result of their own analysis and efforts that may not have occurred to other analysts. Analysts should be able to raise these issues with the issuer independently and expeditiously. The market is highly time sensitive, and it is in the interests of market efficiency that such issues are resolved without delay, and not await the next scheduled group meeting.

Provided of course that no non-public information has passed in a one-on-one meeting in response to the analyst's enquiries, the analyst should also be able to derive the benefit of their analytical efforts and be the first to report their analysis to their clients.

A requirement that the only forum for communicating with a company would be group meetings would mean that all present could free-ride on the work of a particularly astute analyst, which could act as a disincentive to analysts to engage in probing analysis and as a disincentive to broking firms to carry the

considerable costs of supporting a research arm. This would not further market efficiency.

It should be noted that financial journalists perform a function not dissimilar to research analysts, and both groups should be free to meet with issuers on the basis of similar principles.

Market fairness considerations. We note the concerns in 4.6.1 of the Issues Paper. SDIA appreciates that questions of market fairness and perceptions of equality of access to information may arise where a company engages in selective including one-on-one briefings, and that these perceptions can be important even where no breach of the law may be occurring.

However, as mentioned earlier, these considerations were equally prominent at the time of the lengthy review of equity research which took place in 1998-2000, including ASIC's Grapevine project, and SDIA believes that the measured response at the time, including the various Guidelines referred, to remain effective to deal with any such concerns today.

Whether new Rules required. SDIA notes that the various Guidance issued on this subject does not have the force of law, and that this might be seen as unsatisfactory.

As mentioned earlier, SDIA believes that the existing measures operate well and statutory Rules are not needed. In our submission, it is important that the flexibility which is built into the various Guidance notes not be lost, and it is difficult to see how Regulation could be drafted that would not be at the expense of such flexibility.

As regards SEC Rule 100 in particular, we note that the Rule requires that material non-public information should be disclosed publicly by an issuer simultaneously with an intentional selective disclosure and promptly in the case of an unintentional disclosure. The preferable position, in our view, is that disclosure of such information should always first be to the market (as set out in the Australian Listing Rules and other Guidance noted above). Also, we do not see much to be gained by making it a legal requirement to promptly remedy an unintentional disclosure, as it would be hard to see this not happening as a matter of course as a result of the Listing Rules.

If Regulation is seen as essential to attach the force of law to obligations in this area, considerable care is needed in drafting the Rules to ensure that they positively contribute to regulation and that they do not remove much needed flexibility.

Record keeping of briefings. In the current economic climate, additional costs and regulatory burden are a significant issue for listed companies and for brokers. SDIA would argue strongly that any record keeping requirement that might be introduced should be simple and low-cost.

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 on (02) 8080 3200 or email pstepek@sdia.org.au .

Yours sincerely,

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