Stockbrokers
And Financial Advisers
Association Limited

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ASIC CONSULTATION PAPER CP 290 – SELL SIDE RESEARCH
SUBMISSION BY STOCKBROKERS AND FINANCIAL ADVISERS ASSOCIATION

We refer to the ASIC Consultation Paper CP 290 – Sell Side Research ("CP 290") and the Draft Regulatory Guide attached to CP 290 ("the Draft RG"). The Stockbrokers and Financial Advisers Association ("SAFAA") appreciates the opportunity to provide a submission on CP 290 and the Draft RG.

We set out some general observations in this covering letter, and attach a Table addressing the specific Questions in CP 290.

General Submissions

SAFAA supports the maintenance of the integrity and high standing of equities research. Under its former name SDIA, Best Practice Guidelines for Research Integrity were drafted in conjunction with the Securities Institute of Australia (SIA). These Best Practice Guidelines have applied to SAFAA members ever since.

The Best Practice Guidelines contain a number of Principles which go to the heart of the key concerns on which ASIC is addressing guidance in CP 290.

We are supportive of better guidance to industry through CP 290, however we make the following general submissions in relation to ASIC's approach in CP 290.

1. **Removing potential for confusion.** As a preliminary comment, we believe it would be preferable to have one RG dealing with research conflicts, not two separate ones. This would improve clarity. Members believe it would be preferable for additional guidance to be incorporated into RG 79, or RG 79 be repealed and its content incorporated into the proposed new RG.

2. **Restriction on the use of analysts is not supported**. Members consider the proposals in CP 290 unnecessarily restrict the ways in which analysts may be employed in relation to capital raising transactions, and their ability to interact with issuers. This will make the process less effective and more costly. Members consider that the restrictions are not justified.

   CP 290 and the Draft RG appear to be indicative of a lack of faith by ASIC in the ability of firms to manage conflicts of interest and MNPI. ASIC refers to the Toys R'Us matter, which occurred in the US, cites "instances" of local matters in Australia, but they are not named. In SAFAA's submission, there is simply not the track record of substantial failures in relation to research in Australia that would justify the highly prescriptive regime set out in CP 290 and the Draft RG.

   In this regard, we note that ASIC's own Market Cleanliness Report has indicated that the market is cleaner than at any time since it took over the market supervision function.

   Stockbroking firms are used to managing the conflicts that can arise in their businesses, and do so effectively and with careful thought in our view. Firms already possess good processes for dealing with the issue, partly in response to previous ASIC Guidance, such as in RG 79.

   Research analysts are the subject matter experts employed by firms. Research capability is also quite expensive to maintain. Firms have a legitimate right to utilise the resources of their research departments for the commercial benefit of their businesses, subject of course to complying with applicable laws and regulations.

   Members have voiced the concerns quite strongly that they need to able to call on the input of research analysts at various stages, including in the course of determining whether the firm will undertake a transaction for the issuer, which

may involve risk to the firm's reputation and capital in the course of so acting. It is preferable, in SAFAA's view that firms rely on the analyst views, and valuations, in preference to those of ECM or Corporate departments. It is entirely appropriate to employ analysts and exchange their views with other parties during the course of a transaction.

A key function of a research analyst is to obtain a view that is independent of company management, and to critically test what management of the company is saying.

In SAFAA's submission, parts of CP 290 unduly isolate the analyst from carrying out the key roles that are described above.

SAFAA recognizes the potential for firms and analysts to behave inappropriately in relation to a transaction. This has clearly happened in the US cases that have been reported publicly. SAFAA submits that these are matters that should be dealt with properly by ASIC taking appropriate enforcement action. Individuals and licensees who fail to meet the required standards should be prosecuted.

However, it is not the right course of action to deal with the potential for risk by isolating all analysts in the way that is proposed by many of the sections in CP 290 and the Draft RG, or by adding layers of bureaucratic process, in order to obtain some comfort that any potential for risk is minimised. Firms are aware of their obligations, and have (or should have) in place processes to manage those issues, and are experienced in doing so.

3. **Reliance on compliance bureaucratic and unrealistic.** Many of the proposals in CP 290 and the Draft RG rely on compliance staff acting as a gatekeeper of communications involving analysts and others. These proposals are highly bureaucratic. With the best will and diligence in the world, this is likely to complicate and slow down the process of communications, and is unlikely to lead to any better outcomes. Timely access to information is of utmost importance to investors, and the level of process that is proposed in CP 290 will undoubtedly impact on this. The controls that are being proposed in our submission go beyond what is appropriate or efficient.

   The reliance on compliance staff to supervise these communications, and also the quality of research, assumes a level of knowledge and skills regarding research that compliance does not possess. Those proposals will generate a significant level of complexity and cost but not lead to a better outcome.

4. **Providing research coverage to issuers.** There is an inherent assumption in CP 290 that offering research coverage to an issuer in connection with a pitch for a transaction irrevocably corrupts the integrity of the research. SAFAA challenges this assumption.

   There is a big difference between offering to provide research coverage to an issuer, and offering or promising **favourable** research coverage. The latter is undeniably inappropriate. Research must be objective, free from interference, and have a reasonable basis.

   There is a major lack of research coverage of companies in the Australian market. This is a problem for issuers, and affects their access to capital. Without research coverage, investors are unlikely to be attracted to a company. Correspondingly, the lack of research also affects investors, who are looking for analysis of new companies in which to invest.

   The problem of available research is such that ASX, for example, has offered programs under which brokers are paid to provide a certain level of research coverage to companies that are not presently covered.

   The lack of research is particularly apparent amongst issuers at the very small end of the market, and in particular, at the start-up phase. This includes entrepreneurial companies, fintech, biotech and the like, which is precisely the sector that has been identified as being at the heart of Australia's push for economic growth into the future.

   SAFAA challenges the argument that it is not appropriate to offer to provide research coverage as part of an overall commercial approach to an issuer to be appointed for a corporate role. A firm's clients will expect to see research on the issuer in that event, and firms do not have unlimited resources and need to apply some criteria in deciding which companies they can and cannot devote research resources to covering. Any risk of conflict of interest or compromise to the research can be managed by a suitable disclosure in the research of the firm's mandate from the issuer. Clients will take this into account in deciding whether to place reliance on the research and how much.

   From the issuer's perspective, it may well be that obtaining a commitment of research cover at the time of appointing a corporate adviser is the best opportunity the issuer may have to secure research of their company's securities.

   SAFAA stresses that this should not in any way be regarded as detracting from the integrity of research. The content of the research, and the analyst's opinion, must be independent and not influenced by the issuer or anyone else at the

licensee. To do otherwise would infringe SAFAA's own Best Practice Guidelines as well as ASIC's expectations on conflicts management.

5. **Definition of "research" is too wide**. The definitions of "research", and as a consequence that of "sell-side research" in the Draft RG 000.24- 000.27, are very broad. The language looks to be wide enough to include communications and emails sent by sales desk staff. Such communications setting out the views of the adviser are commonly sent out, and can be very popular with clients.

   The conclusion that would follow is that the requirements in the Draft RG applicable to the publication of research and to analysts apply equally to sales desk staff in relation to any relevant communications. Applying those requirements to sales staff would be an administrative nightmare. The process of reviewing and clearing such communications as if they were research, and the volume of potential emails, would result in the communications being so delayed that they would be stale by the time they were sent. To investors, the value of sales desk notes is that they are concise and timely. The end result of the proposed framework is that the communications would in all probability die off.

   The Draft RG should deal with research in the ordinary sense of the term, that is, published research.

6. **Importance of flexibility**. The proposed Guidance should be sufficiently flexible so as not to mandate that small to medium-sized firms adopt processes and resourcing decisions that do not reflect the scale of their businesses.

   Larger firms may be happy to comply with higher process and resource requirements, particularly as they may be able to absorb the costs more readily. Indeed, large firms may already have processes and resource in place in response to US research settlement in 2003.

   ASIC's regulatory guidance should not therefore pursue a "one size fits all" approach and mandate that smaller firms must adopt the same framework, particularly if their businesses does not warrant it. The cost of compliance with higher measures could act to benefit large firms by making the cost structure of their smaller competitors unsustainable. Ultimately, smaller firms would be driven from the market.

   The fundamental outcome of the type of administrative requirements being proposed is that the cost structure of smaller capital raisings will not be affordable.

Specific Questions

Within the context of the General Submissions above, annexed is a Table setting out specific responses to the Questions contained in CP 290 and the specific paragraphs in the Draft RG.

The Submissions and responses are also directly applicable to the corresponding provisions in the Draft RG, which to avoid duplication, we have not separately addressed.

CONCLUSION

We would be happy to discuss any issues arising from these comments, or to provide any further material that may assist. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au.

Yours sincerely,

Andrew Green
Chief Executive

Encl.