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Mr John Kluver
Executive Director
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Dear Mr Kluver,

Aspects of Market Integrity

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments on the Corporations and Markets Advisory Committee's issues paper *Aspects of Market Integrity*. We appreciate the additional time given to us to collate our members' views.

1. Opening remarks

The ABA commends the Federal Government for examining these issues and resisting the urge to take legislative or regulatory action without having a thorough understanding of the complexity of these issues, particularly in the context of the global financial crisis. Rushed decisions can often result in errors or unintended consequences.

Maintaining the integrity of our markets is paramount to ensuring efficiency and preserving confidence of investors. It is important for Australia to maintain a strong and effective regulatory and corporate governance framework for Australia's listed companies, reporting entities, market participants and the business community to ensure investor, shareholder and stakeholder confidence. It is our view that Australia's regulatory and corporate governance framework has proven to be robust in the recent difficult economic and market conditions.

Transparency and accountability is critical to market integrity. Market participants, investors or others that deliberately spread false information to negatively affect a share price should not be tolerated and should be prosecuted. Therefore, we support measures that go to improving transparency and accountability and addressing actual and perceived practices and behaviours that may undermine the integrity of the market.

The ABA believes:

1. It is unnecessary to amend the existing laws regarding margin lending to directors, 'blackout' trading by directors or corporate briefings to analysts. However, we support a review of the law to ascertain whether it is appropriate to apply civil penalties to contraventions of the market manipulation provisions.

2. The ASX Corporate Governance Council should review its *Corporate Governance Principles and Recommendations* with a view to: (1) providing additional guidance specifically on margin lending to directors and 'blackout' trading by directors; and (2) ascertaining whether further guidance on corporate briefings to analysts is required to supplement existing guidance by ASIC and the ASX. However, it is important to ensure that any changes balance enhancing disclosure practices and information for investors with minimising regulatory burden and compliance costs for companies. It is vital that Australia's market remains efficient and orderly and the cost of raising capital remains competitive.

2. Specific comments

2.1 Margin lending to directors

Shareholdings by directors has long been held to promote market efficiency by directly aligning the interests of directors with those of the company's shareholders. We believe that margin lending and other funding arrangements can form an important part of share purchase arrangements. Therefore, directors should not be prohibited from borrowing to purchase shares in their company. However, directors are in a unique position in that they have a legal obligation to exercise care and diligence and act in the best interests of the company[1] as well as they can have access to company information, including price sensitive information.

The ABA notes that in February 2008, ASIC and the ASX issued an update reminding companies that where a director of a company has entered into a margin loan or similar funding arrangement for a material number of securities, ASX Listing Rule 3.1 may operate to require the company to disclose the key terms of the arrangements, including the number of securities involved, the trigger points, the right of the lender to sell unilaterally and any other material details. Furthermore, the update emphasised that whether a margin loan arrangement is material is a matter which the company must decide having regard to the nature of its operations and the particular circumstances of the company[2].

The ABA believes:

- Directors of the company must disclose to the Board any material personal interest they may have in a matter that relates to the affairs of the company[3].
- Directors of the company must disclose to the Board their relevant interests in the company, including shareholdings, other equity-linked interests, and margin lending and other funding arrangements, as well as provide all details concerning the operations of those interests. Boards and companies must possess all relevant information about the margin loan or similar funding arrangement to assess whether it constitutes a substantial shareholding. Boards should determine when margin loan arrangements are material to the company and therefore warrant disclosure to the market.

[1] Sections 180 and 181 of the Corporations Act.
[2] http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/MR%2008-37.pdf/$file/MR%2008-37.pdf
[3] Section 191 of the Corporations Act.

- Companies should have a policy on trading by directors in their company's shares[4]. The policy should oblige directors to disclose to the company the necessary information required for the company to assess whether a margin loan or other funding arrangement constitutes a substantial shareholding. The policy should also include details of any specific restrictions or conditions a company may impose on its directors entering into margin loans or other funding arrangements[5]. The policy should also include procedures to ensure adequate mechanisms for oversight and compliance with the policy. The policy or a summary of the policy should be made public (i.e. disclosed on the company website and/or in the company annual report).

- Companies must disclose to the market any substantial interests held by a director in the company's shares and any material changes to those interests or arrangements[6]. Companies should disclose to the market a statement as to whether a director has a margin loan or other funding arrangement that is material to the company as well as information concerning those interests or arrangements[7].

- Companies must immediately disclose information that a reasonable person would expect to have a material effect on the value of the company's shares[8].

The ABA does not believe it is necessary to impose additional legal or regulatory obligations through the Corporations Act. Rather the ASX Corporate Governance Council should amend its *Corporate Governance Principles and Recommendations* to explicitly include guidance on companies establishing a policy concerning margin lending and other funding arrangements by directors and senior executives. We suggest that Recommendation 3.2 and commentary be amended.

This approach would ensure that Boards and companies have the flexibility to decide what is material to the company, which is particularly important in volatile market conditions. This approach also recognises that Boards are best placed to judge whether a margin loan or other funding arrangement is material giving consideration to the circumstances of the company and the nature of its operations. This approach also ensures that Boards are able to apply the guidance appropriately to their company, yet does not compromise a consistent approach across listed companies.

However, this approach would not require companies to disclose to the market certain specific details about the margin loan or other funding arrangement of its directors and senior executives. Certain specific details being disclosed to the market (e.g. circumstances in which a margin call could be made) may have adverse and perverse

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[4] The ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* state that companies should establish a policy concerning trading in company securities by directors, senior executives and employees, and disclose the policy or a summary of that policy (Recommendation 3.2).

[5] Companies should disclose in their policies whether margin loans are prohibited or restricted by directors, for example, a company may impose a restriction on the use of the company's shares as security for the loan unless the director can demonstrate financial capacity to repay the loan or meet a margin call without resorting to the forced sale of the pledged shares.

[6] ASX Listing Rule 3.19A requires disclosure within 5 business days. The ABA notes that section 205G of the Corporations Act requires disclosure within 14 days. The ABA also notes that section 671B of the Corporations Act requires disclosure of substantial shareholdings within 2 business days. The statutory obligations and ASX Listing Rules should be aligned to 2 business days, with the exception of dividend reinvestment plans (DRPs) where the obligation should remain at 14 days.

[7] Boards should exercise judgment in deciding whether the shareholding and margin loan arrangement is material in the particular circumstances, and accordingly, how the company is to meet its disclosure obligations under the law. It is important to balance informing the market about margin loans by directors and maintaining the privacy of directors. The disclosure requirement should align with the substantial shareholder regime (section 671B of the Corporations Act).

[8] ASX Listing Rule 3.1.

affects. It is important to balance enhanced disclosure of margin loans by directors with providing too much information, which could be exploited and result in manipulative trading[9].

The ABA believes that standards applied to directors should also apply to senior executives of companies and similar persons in similar entities, including listed managed investment schemes.

With regards to margin lending by directors, the ABA notes the following:

- Commentary on directors' margin loans made by the Australian Institute of Company Directors (AICD)[10]; and
- Commentary on directors trading and margin loans made by the Investment and Financial Services Association (IFSA) and the Australian Council of Superannuation Investors (ACSI)[11].

2.2 'Blackout' trading by directors

Banks and other companies have adopted trading policies for ensuring compliance with the insider trading laws and market manipulation provisions. Recommendation 3.2 of the *Corporate Governance Principles and Recommendations* requires a listed company to publish its policy concerning trading in the company's shares by directors, officers and employees. Furthermore, while trading during 'blackout' periods may not be explicitly prohibited in the law, trading by directors may contravene the insider trading laws, market manipulation provisions, and statutory and fiduciary obligations for directors not to improperly use their position or company information for personal advantage.

Directors trading during 'blackout' periods could undermine the integrity of the market. A perception by investors that there may be breaches of the law can undermine investor confidence and the reputation of the market. Therefore, it is important to ensure that companies have in place policies that promote practices that maintain confidence in the governance of the company, including practices for addressing actual or potential incidences of illegal and unethical behaviours.

Directors that trade on price sensitive information and contravene the insider trading laws or market manipulation provisions should not be tolerated and should be prosecuted. However, a director trading during a 'blackout' period may not constitute a breach of the law. In exceptional circumstances, directors that do not possess price sensitive information should be able to trade. Exceptional circumstances could include:

- Where the director would suffer severe personal financial hardship;
- Where a court order is issued relating to the financial position of the director;
- Where the director participates in an employee share scheme or dividend reinvestment plan (DRP); and
- Where the director undertakes a transaction involving the exercise of an option or the uptake of qualification shares.

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[9] The ABA notes that if the market price of the shares that would trigger a margin call is known to the market, certain traders could target a company where a director has a margin loan or other funding arrangement to deliberately force the share price down to trigger a margin call and potential sale of the shares.
[10] *Position Paper No 9: Director margin loans*. 21 July 2008. http://www.companydirectors.com.au
[11] *Joint Statement by IFSA and ACSI on Market Integrity and Efficiency*. 28 March 2008. http://www.ifsa.com.au/

The ABA believes:

- Directors of the company that possess price sensitive information, or a person related to them, must not trade the company's shares or linked financial products during 'blackout' periods.
- Companies should have a policy on trading by directors in their company's shares. The policy should clearly identify what constitutes a 'blackout' period, prohibit trading during a 'blackout' period for those in possession of price sensitive information, and outline any exceptional circumstances and procedures for discretionary decisions by the Board. The policy should also include details of procedures to ensure adequate mechanisms for oversight and compliance with the policy. The policy or summary of the policy should be made public (i.e. disclosed on the company website and/or in the company annual report).
- Boards should determine when trading may be permitted due to exceptional circumstances[12].
- Companies must disclose to the market any substantial interests held by a director in the company's shares and any material changes to those interests or arrangements. Companies should disclose to the market a statement as to whether the Board has exercised its discretion in allowing a director to trade during a 'blackout' period.

The ABA does not believe it is necessary to impose additional legal or regulatory obligations through the Corporations Act. Rather the ASX Corporate Governance Council should amend its *Corporate Governance Principles and Recommendations* to explicitly include guidance on companies establishing a policy concerning trading windows and 'blackout' periods.[13]. We suggest that Recommendation 3.2 and commentary be amended.

The ABA notes that the ASX should continue to conduct reviews of trading by directors during 'blackout' periods.

2.3 Spreading false and misleading information

Market rumours can have a significant impact on the efficiency and integrity of the market. We are concerned about false information being deliberately spread across the market – referred to as 'rumourtrage' – especially recently during the global financial crisis and market turbulence. Rumourtrage, coupled with aggressive short selling, can distort the market and have destructive consequences for share prices, and with regards to bank stocks, can have serious consequences for the stability of banks and the banking system.

The ABA notes that the Federal Government, ASIC and the ASX have recently taken actions to address concerns about abusive short selling in Australia's market, for example, enhancing disclosure of short selling data. However, disclosure of short sales does not address concerns regarding potentially collusive behaviour, predatory trading, rumourtrage

[12] The ABA notes that investors must have assurances that appropriate systems are in place to make sure that proper approval and adherence procedures are maintained. Any exceptions available for directors should also be made available for other officers and employees that are otherwise subject to similar trading restrictions.

[13] Additional guidance should seek to build on existing obligations with regards to the insider trading laws and market manipulation provisions, for example, identify proper approval and adherence procedures and exceptional circumstances where trading may be permitted by directors, senior executives and other employees that have access to company information. The ABA notes that the Model Code issued by the Financial Services Authority (FSA) in the United Kingdom and Rule 10b5-1 made by the Securities and Exchange Commission (SEC) in the United States could be given consideration in terms of enhancing guidance in this area, especially with regards to exceptional circumstances relative to ensuring compliance with legal obligations in this jurisdiction.

and false information being deliberately spread across the market. These are challenging regulatory issues – in particular, establishing what constitutes a rumour and finding the evidence of this market misconduct in Australia and overseas can be extremely difficult.

The ABA observes that some recent examples of rumourtrage, information that has been, or could have been, seriously damaging to a company's reputation and share price, has allegedly been spread by market commentators or others that could claim the information to be a matter of opinion. It is important to bear in mind that a rumour may not simply be information that is factually incorrect, but also information that is baseless, yet equally able to have adverse consequences for the company's shares as well as the efficiency and integrity of the market.

The Corporations Act prohibits a person in this jurisdiction or elsewhere from making a statement or disseminating information if the information is false in a material particular or is materially misleading and where the statement or information is likely to induce persons in this jurisdiction to trade[14]. It is important for regulators to have adequate powers and remedies to detect and take action against inappropriate market behaviour. Criminal offences and civil penalties should apply to the most egregious behaviour and severe contraventions in the law.

The ABA notes that in March 2009, the Financial Services Authority (FSA) in the United Kingdom introduced an obligation on stock brokers to record, and retain for six months, certain electronic communications. While there may be some appeal in introducing a similar obligation in Australia, we are uncertain as to the effectiveness of such a measure. Recording communications of stock brokers would likely result in capture of an incredible amount of information that would likely lead to inefficient investigations. Having said that, it is unlikely to capture all communications (e.g. only relating to execution of client orders, not general discussions about market conditions or company/sector performance) and it is unlikely to apply to communications of all persons that may be in a position to initiate and/or spread rumours. Abusers are likely to find other ways to get around the law. Recording of communications also raises privacy issues. It should also be noted that the requirement to record conversations during a takeover bid were recently repealed from the Corporations Act.

The ABA believes it is important for companies to make sure they have procedures in place for dealing with market rumours. ASIC and the ASX have both issued guidance for companies to use in responding to rumours or speculation to ensure that the market is fully informed[15]. While existing guidance is helpful in assisting companies meet their legal obligations, we observe that in some cases the rumour is not clearly linked to a piece of information or supposedly single fact – that is, some assertions may be very general, yet still able to have adverse consequences for the company's shares. In these cases it is difficult for companies to respond and issue information to the market to counteract the rumour.

[14] Section 1041E of the Corporations Act.
[15] *Heard it on the Grapevine* issued by ASIC and Guidance Note 8 issued by the ASX.

The ABA believes:

- The Government should conduct a review of Part 7.10 Division 2 of the Corporations Act (market manipulation provisions). Further consideration should be given to the offences relating to market misconduct and manipulation with a view to assessing the adequacy of current prohibitions, offences and defences and the difficulties of detection, investigation of suspected contraventions of the law and associated practices (i.e. collection of evidence) and enforcement, especially in light of the emergence of electronic communications[16].

- The Government should give further consideration to: (1) how rumours may spread across the market, including by commentators that may, or may not be market participants, financial service providers, or directors, officers or employees of a listed company; and (2) culpability for initiating and/or spreading rumours, so that a targeted response to market rumours can be implemented[17].

- ASIC, ASX and industry representatives should review existing guidance with a view to developing a new guidance package that promotes good industry practice, industry and market awareness of market misconduct and the consequences, and good disclosure to investors.

The ABA notes that ASIC has recently established a facility for the reporting of rumours and other false information. This facility will hopefully assist the regulator monitor and take action against rumourtrage.

2.4 Corporate briefings to analysts

The ABA recognises that some have the perception that analyst briefings are unfair – this misperception can be damaging to the reputation of the market. We believe analyst briefings play an important role in the market by enhancing information flow for the benefit of all investors. Open communications that take place in a professional manner contribute to pricing efficiency and the orderly functioning of the market[18]. For example, banks have briefings and discussions with analysts and other professionals in order to provide information, and explanation and interpretation of that information. Restricting banks and other companies from conducting briefings (e.g. prior to the publication of periodic financial results) would have adverse consequences for the quality of information in the market.

Many companies conduct public briefings rather than private briefings. During public briefings companies may refer to, or provide research analysts with, any information that is already in the public domain. Companies must not disclose information in a briefing that is intended for the market until it has been released by the ASX[19]. Companies manage briefings with analysts by keeping a record of discussion points, questions and responses. However, some briefings may inadvertently involve the discussion of commercially

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[16] The ABA notes that in 2007 the Government commenced a review of sanctions for breaches of corporate law. This review should give specific consideration to the market manipulation provisions.

[17] The ABA notes the description of market manipulation as contained in the EU *Market Abuse Directive*. This description explicitly refers to the use of the media or Internet to spread false and misleading signals as to financial instruments. The current provision in the Corporations Act is silent as to the way false and misleading statements may be spread. We consider that it is not necessary to explicitly identify some forms of communications, as this risks that as new technologies develop there may be some uncertainty with regard to the application of the provision to those new forms of communications. However, it would be reasonable for ASIC and the ASX to provide guidance on how persons, technologies or facilities may be used to spread false and misleading statements.

[18] *Principles for Building Better Relations Between Listed Entities and Analysts*. 16 August 2006. http://www.aira.org.au/ and http://www.finsia.com

[19] ASX Listing Rule 15.7.

sensitive information. In this instance, companies must assess whether the information it disclosed constitutes information that is materially price sensitive, and therefore should be made 'generally available' to the market[20]. It is important that briefings do not inappropriately result in information asymmetries. In this regard, it is our view that the continuous disclosure regime is adequate in these circumstances.

The ABA notes that during briefings, analysts and other professionals may make deductions, interpretations or draw conclusions that are their intellectual property. Companies should not need to disclose or explain those deductions, interpretations or conclusions in meeting its continuous disclosure obligations. Any response made by the company to those deductions, interpretations or conclusions should be treated in the same manner as anticipated disclosures. Furthermore, companies may need to give consideration to the intellectual property of analysts and other professionals in how the company intends to meet its continuous disclosure obligations and/or make briefings available to a wider audience. Public disclosure of analysts' intellectual property may discourage participation by analysts in briefings to the detriment of the efficient and orderly functioning of the market.

In some cases companies conduct private briefings. We believe private briefings are a valuable mechanism for ensuring that analysts and other professionals properly understand the information. Private briefings can be held to enable analysts and other professionals to clarify points and interrogate information that is already in the public domain so that they can produce accurate recommendations, ratings and reports. Some briefings may involve the discussion of commercially sensitive and non-public information. Limiting these types of briefings would have significant and adverse consequences for a fully informed market, the operations of banks and other companies, and the quality of information in the market (i.e. credit ratings). In this regard, it is our view that the prohibitions on insider trading are adequate in these circumstances.

The ABA believes:

- Companies should have a policy on ensuring compliance with the continuous disclosure and insider trading laws. The policy should identify how companies will conduct briefings and respond to shareholder enquiries as well as how intentional and non-intentional disclosures during public and private briefings will be managed. The policy should also include details of procedures to ensure adequate mechanisms for oversight and compliance with the policy. The policy or summary of the policy should be made public (i.e. disclosed on the company website and/or in the company annual report).

- Companies should consider ways of making briefings conducted with research analysts and other professionals more broadly available, including via webcasts or posting summaries on the company website concurrently with conducting the briefing or posting a transcript on the company website following the briefing.

The ABA believes existing guidance by ASIC and the ASX on analyst briefings is adequate, and therefore it is not necessary to impose additional legal or regulatory obligations through the Corporations Act. Having said that, the ASX Corporate Governance Council should review its *Corporate Governance Principles and Recommendations* to assess whether its guidance should be amended to further reinforce the principles of fair and equal access as contained in existing guidance by ASIC and ASX.

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[20] ASX Listing Rule 3.1.

With regards to corporate briefings to analysts, the ABA notes the following:

- Commentary on analyst briefings and the exchange of information between companies and analysts made by the Australasian Investor Relations Association (AIRA) and Finsia; and
- Commentary on investor relations made by the AIRA[21].

The ABA looks forward to continuing to work collaboratively with the Federal Government on its responses to concerns with market integrity and related issues. If you would like further information on any of the matters raised in this letter, please contact the ABA.

Yours sincerely

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Diane Tate

[21] *Best Practice Investor Relations: Guidelines for Australasian Listed Entities*. http://www.aira.org.au/IRM/content/publications_bestpractice.html