42/120 Collins Street GPO Box 1472 Telephone +613 8664 2664
Melbourne 3000 Melbourne 3001 Facsimile +613 8664 2666

www.bca.com.au

13 March 2008

Business Council of Australia

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Email: john.kluver@camac.gov.au

Dear Mr Kluver

ASPECTS OF MARKET INTEGRITY

The Business Council of Australia (BCA) welcomes the opportunity to make a submission to the Corporations and Markets Advisory Committee's (CAMAC) discussion paper *Aspects of Market Integrity*.

The BCA represents the chief executives of over 100 of Australia's leading companies. The BCA develops and advocates, on behalf of its members, public policy reform that positions Australia as a strong and vibrant economy and society. The businesses that the BCA members represent are among Australia's largest employers and represent a substantial share of Australia's domestic and export activity.

The BCA commends the government for referring the issues of market integrity to CAMAC for review. The BCA considers that regulatory intervention in markets should only occur where there is a clearly identifiable problem to be addressed and the costs of the regulation do not outweigh the benefits to the community and business. Accordingly, the BCA is supportive of a public consultation process that enables consideration of the issues and appropriate responses.

The aim of the discussion paper is to focus on aspects of market integrity including margin loans, rumourtrage and analyst briefings. This submission addresses those three elements of the inquiry in turn below.

The BCA considers that in general, the Australian corporate governance environment is already effectively regulated, through a number of mechanisms such as corporations laws, ASX Listing Rules and ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (ASX Governance Principles). Whilst the BCA recognises that there may be market problems in some areas such as rumourtrage, it is important to ensure that any response to these concerns is effective in addressing them and does not impose administrative or regulatory costs which are disproportionate to the problem be addressed. Inefficient and costly regulation affects all Australians through higher costs and is a major barrier to our continued economic growth and prosperity.

The Australian corporate governance regime is unique. For example, a flexible 'if not, why not' system operates in conjunction with regulation. This system has positioned Australia comparatively well, providing an efficient and flexible regime for company operations. CAMAC has stated that it will *'continue to review relevant law and practice in overseas jurisdictions and welcomes any information that respondents may wish to provide.'* Whilst it may be useful to seek comparisons from overseas, they must be considered in the context of their applicability to the Australian environment, an environment which has proven to be robust in comparison to many competitors.

1. Margin loans

The BCA does not believe that additional regulation is currently needed in relation to margin lending in the context of director's or other officer's holdings.

Evidence of a problem

Some specific instances of margin loans supporting substantial shareholdings of directors and executives were highlighted as a problem around late 2007 and during 2008. Companies and directors acted quickly to deal with this issue, and it is likely that the incidence of margin loans supporting significant shareholdings has now diminished. ASIC and the ASX also released an update in February 2008 to assist companies to deal with their obligations with respect to margin loans. In general therefore, the problem seems to be less urgent than it may have been when this issue arose in 2007 and 2008.

There are a number of existing regulatory requirements that operate in combination to effectively deal with the issue of margin loans, including:

- the continuous disclosure regime under ASX Listing Rule 3.1;
- substantial shareholding provisions in the Corporations Act;
- director disclosure of material personal interests under section 191 of the Corporations Act; and
- director disclosure to ASX of shareholdings under section 205G of the Corporations Act.

In addition to regulatory requirements, other practices deal with margin lending. These include:

- Recommendation 3.2 of the ASX Governance Principles which requires listed companies to establish a policy concerning trading in company securities by directors, senior executives and employees and to disclose that policy or a summary of that policy to the market.

- An update released by ASIC and ASX in February last year which highlighted that certain circumstances may require disclosure of details of a director's funding arrangements under Listing Rule 3.1. The update highlighted that an assessment of materiality and therefore extent and timing of disclosure of such information is a matter for the board to decide in the circumstances of the individual company.

Costs and benefits of intervention

Margin loans and other funding arrangements facilitate the purchase of shares in a company. Undue restrictions on borrowing to acquire shares should be avoided. It is important to encourage share ownership by directors and officers in their companies. For example, share ownership and remuneration in the form of shares is an important mechanism for tying the interests of directors and officers to the company's interests.

Additionally, start-up companies may require funding by founder directors in the company. Hindering such investments could be detrimental to innovation or shareholder value.

There is a risk in going beyond a flexible regime and for example mandating public disclosure of specific details of funding arrangements. Mandatory requirements for public disclosure could put companies or individuals in a vulnerable position. If specific details such as trigger points for margin calls are disclosed, this may encourage some market players to target vulnerable companies to manipulate share prices.

Possible response

Additional guidance in the ASX Governance Principles could be developed to assist companies in dealing with their trading policy under Recommendation 3.2. The guidance could cover a range of issues associated with company trading policies, including:

- trading policies could detail the circumstances under which a director or officer can take out a margin loan; or

- trading policies could mandate disclosure to the board by a director or officer of details about a margin loan. Such disclosure will enable the board to assess in a timely way, the details of a margin loan for the purposes of ASX Listing Rule 3.1, whilst also allowing the boards continued flexibility to make decisions of materiality.

2. Spreading false and misleading information

The BCA is concerned about the incidence of false and misleading information being spread in the market ('rumourtrage') particularly given the impact that this has had on the integrity of the market in the current economic climate.

Evidence of a problem

Regulators must be able to, as far as possible, detect and take action against inappropriate market behaviour. However, it appears that there may be some current difficulty in regulators being able to detect where rumourtrage is being originated and in holding those responsible to account.

Even if such a problem has been demonstrated, a targeted and proportionate response must be taken if the problem is to be addressed and unintended consequences avoided.

Costs and benefits of intervention

The proposal for compulsory recording of telephone conversations and other electronic forms of communication must be considered in context of whether it will enhance the ability for regulators to combat rumourtrage. As with any regulatory intervention, the benefits must outweigh the costs.

There are a number of costs and risks associated with compulsory recording of conversations. Compulsory recording may for example divert significant resources away from more effective investigation by regulators towards time consuming activities like reviewing large amounts of non-material information. Indeed, prior experience with compulsory recording in Australia resulted in it being disbanded because of the undue costs associated with the program. CAMAC's discussion paper highlights that the requirements to record telephone conversations during a takeover bid were repealed *'on the basis they did not increase the protection of security holders and imposed significant costs on the parties involved'*.

In addition to the costs and risks, it is unclear how the proposal will in practice increase the regulator's ability to investigate and take action against inappropriate behaviour. For example, only certain regulated market participants in Australia will be captured by the recordings. If overseas or unregulated market participants are spreading rumours, they may not be captured by the compulsory recording regime. It is likely that alternative methods of behaviour will be employed by individuals to avoid the recording regime (for example, face to face meetings).

Possible response

There may be some merit in undertaking a more specific review of the market manipulation provisions of the Corporations Act, to ensure they are simpler, less conflicting and able to be effectively applied by the regulators. However, a more detailed analysis (with longer periods for consultation and analysis) would be required for such a review.

Recognising that regulators may be having difficulty in identifying and taking action against those spreading false and misleading rumours, the BCA considers that any proposals to deal with rumourtrage must be given due consideration to ensure responses are targeted, proportionate and avoid unintended consequences.

3. Corporate briefings to analysts

The BCA does not consider that additional regulation or guidance is required in relation to analyst briefings.

Evidence of a problem

Existing regulation and guidance already sufficiently deals with corporate briefings to analysts, including the continuous disclosure regime under Listing Rule 3.1, insider trading laws and ASX Corporate Governance Principles (eg Recommendation 8). The BCA is not aware of any evidence of a problem with respect to the current regime and as such does not believe there is sufficient evidence to justify any regulatory or other intervention in this area.

Analyst briefings play an important part in Australia's financial market by providing shareholders with timely and useful information. The current environment allows companies to develop communication methods on a case-by-case basis, depending

on an individual company's shareholder base. This is more likely to be beneficial to shareholders, than imposing prescriptive obligations upon companies. Burdensome requirements might hinder the process and therefore the timeliness and extent of information flow in the market.

Costs and benefits of intervention

a) Public briefings

The BCA does not consider that a proposal for all public briefings to be webcast or podcast or transcripts provided, is necessary.

Many organisations already provide webcasts of significant briefings like annual results and AGMs. However, a prescriptive approach to webcasting of all public briefings may act to the detriment of some organisations that do not already undertake such a process and would find it costly or burdensome to do so.

Most companies also undertake public briefings on a smaller scale, an ad hoc basis and in various different locations. For example, companies may hold annual board or customer dinners where investors and analysts are invited. Executives may be invited to speak interstate or overseas at conferences or briefings. Those sorts of events may be difficult and costly to webcast or to have transcribed.

b) Private briefings

The BCA considers that private briefings to analysts increase market efficiency by increasing the information flow in the market.

A proposal for mandatory record-keeping requirements (eg transcripts or recordings) could be overly restrictive. Open flow of dialogue has proven to be useful for both companies and investors. For example, an investor may wish to express an opinion on leadership styles. Investors should be able to express their views on matters of opinion without the risk of them being made public.

4. Conclusion

In general, the BCA does not support additional regulatory burdens or requirements being imposed on market participants in the areas of the market integrity inquiry discussed above, particularly if a sufficient problem has not been evidenced. In addition, any intervention in markets must be proportionate to the problem and avoid unintended consequences. Additional guidance in the areas indicated above should be considered as an alternative to regulatory intervention.

If you have any questions or require any further information, please contact me or Ms Leanne Edwards on (03) 8664 2614 or leanne.edwards@bca.com.au.

Kind regards

Melinda Cilento
Deputy Chief Executive