Law Council
OF AUSTRALIA

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Dear Mr Kluver,

CAMAC Issues Paper: Aspects of Market Integrity

I have pleasure in enclosing a submission in response to CAMAC's Issues Paper "Aspects of Market Integrity" which has been prepared by the Corporations Committee of the Business Law Section of the Law Council of Australia.

The submission has been endorsed by the Business Law Section. Owing to time constraints, it has not been reviewed by the Directors of the Law Council of Australia.

If you have any questions, in the first instance please contact the Committee Chair, Greg Golding, on [02] 9296 2164.

Yours sincerely,

Bill Grant
Secretary-General

10 March 2009

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Law Council of Australia

Response to CAMAC's issues paper: *Aspects of market integrity*

This is the submission of the Corporations Committee of the Business Law Section of the Law Council of Australia ("**the Committee**") in response to the Corporations and Markets Advisory Committee ("**CAMAC**") issues paper: *Aspects of market integrity*, released in February 2009.

1 Introduction

1.1 Support for Ministerial reference to CAMAC

The Committee commends the Minister for Superannuation and Corporate Law, the Hon. Senator Nick Sherry's decision to refer these issues to CAMAC for review. The Committee believes it is highly desirable that the market be given an opportunity to comment on proposals to change corporate law before the Government determines whether there should be any regulatory or legislative change. By means of referrals of this kind, decisions about regulatory and legislative change can be made on mature reflection, taking into account all implications, and the Committee considers that this will lead to better laws, avoiding errors which are made when decisions are taken in the heat of a current issue. The Committee hopes that this example will continue to be followed.

1.2 Caution concerning comparative law examples

The Committee notes that a term of the Minister's reference was to take account of the way in which some of these issues are being handled overseas. The Committee acknowledges that comparative analysis is often helpful for the purposes of identifying issues for discussion. However, the Committee cautions that any decision to "cherry pick" from other regimes should be taken only after taking full account of differences between the totality of the regime from which they are taken and Australia's corporate law system. Some elements of foreign regimes make sense in the context of the whole regime, and they can have unintended consequences when grafted onto another system. Further, the Committee considers that the Australian corporate laws referred to in the paper are, for the most part, effective in combating wrongdoing and generally operate well. Central to these are the continuous disclosure regime and the role played by the ASX Corporate Governance Council, both of which are peculiar to the Australian system and assist Australia to address appropriately issues which other countries have addressed in other ways.

1.3 Need for review of market manipulation laws

The Committee advocates a review of Part 7.10 Division 2 (the market manipulation provisions)of the Corporations Act. Many of the issues addressed in the discussion paper and others (for example concerns around short selling) which have arisen in recent years are symptoms rather than causes. The underlying issue is

the difficulty of enforcement of our market manipulation laws and the fact that they have failed to keep pace with developments in the marketplace since many of them were introduced (many after the market failures of the 1970s). Appropriate changes to this regime would better place ASIC to combat not only issues relating to the spreading of false or misleading information through rumourtrage but a range of other issues which have had currency in recent times.

1.4 Summary of the Committee's position on issues addressed in the reference

The Committee does not believe it is necessary to amend the existing laws regarding margin lending, trading in blackout periods or corporate briefings to analysts.

The Committee would support the ASX Corporate Governance Council reviewing whether there is greater scope for guidance on trading during black out periods.

The Committee supports the extension of the civil penalty regime in Part 9.4B of the Corporations Act to sections 1041E to 1041G.

2 Margin lending to directors

The Committee agrees broadly with the statements and conclusions made by Ewen Crouch in his paper *Director's Margin Loans: Disclosure Issues* given last year.[1]

That paper highlighted that the issue of disclosure of margin loans is already contemplated and effectively dealt with by a combination of ASX Listing Rule 3.1 (regarding continuous disclosure), sections 191 (directors' disclosure of a material personal interest) and 205G (director to notify ASX of shareholdings)of the Corporations Act and the substantial shareholder provisions (671B and Chapter 6D more generally). As that paper highlighted, "...there is far more machinery available in the law as it is today than has been appreciated by the marketplace..."[2] This matrix allows appropriate account to be taken of a range of factors such as the size of the loan, the loan to valuation ratio, the market capitalisation of the company, the number of shares to which it relates and the liquidity of the companies' securities (to name but a few) in a way which a law specifically directed at margin loans could not.

The Committee agrees that 205G could be extended to synthetics. This would be an acceptable extension of the law, and the Committee considers that this should form part of the announced Treasury review regarding extending disclosure under Chapter 6C.

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1 Crouch, E, *Director's Margin Loans: Disclosure Issues* in Austin RP (Ed.) "The Credit Crunch and the Law" (2008), Ross Parsons Centre of Commercial, Corporate and Taxation Law, Sydney.

2 Ibid, p 1.

The Committee would also support bringing down the time for directors' disclosure under section 205G to the 5 day period currently provided for under the Listing Rules.

3 Trading in "blackout" periods

It is the Committee's view that no law reform is required in respect of company directors trading during blackout periods.

The ASX Corporate Governance Principles and Recommendations, together with the already established regulatory framework (e.g. prohibitions on insider trading, improper use of corporate position or information and market misconduct) adequately deal with this issue. Having said this, the Committee would support review by the ASX Corporate Governance Council of guidance currently given about trading during blackout periods..

Companies should be left to formulate their own policies (in accordance with the relevant ASX Corporate Governance Principles and Recommendations) which are appropriate to the size, structure and nature of the individual company. There are numerous and substantial difficulties (outlined in Section 2.5.2 of the Issues Paper) regulators would face in attempting to find a "one size fits all" solution.

The Committee supports the ASX initiative of conducting quarterly reviews of directors' trading in the shares of their companies during blackout periods. This type of surveillance puts companies on notice that the ASX is actively monitoring directors trading patterns, prompting companies to advise directors to ensure they comply with the company's trading policies. The Committee encourages the ASX to continue this review process and regularly monitor and publish directors trading patterns during blackout periods.

Issues for consideration

What are the implications of blackout trading for market integrity?

It is the Committee's view that any perception that blackout trading has the potential to negatively impact on market integrity is readily overcome by the various ASX Corporate Governance Principles and Recommendations, ASX Listing Rules, statutory prohibitions and disclosure requirements that effectively regulate the issue of blackout trading. The Committee would like to point out that the 2008 ASX quarterly reports on directors trading during blackout periods was misreported in the media and that this report actually found that problem areas only account for a very small percentage of the relevant trades by directors in shares of their companies.

Would it be beneficial if the ASX Corporate Governance Council provided further guidance to companies about their approach to blackout trading and, if so, what guidelines might be appropriate? (Section 2.5.1)

The Committee would support the ASX Corporate Governance Council reviewing its guidance on trading policies and blackout periods to see if more useful guidance could be given. At present, the only reference to trading windows and blackout periods in the Corporate Governance Principles and Recommendations is a suggestion in section 3.2 that companies should "*identify whether trading windows or black-outs are used and if so, details of their application*". The Committee would not object to a recommendation that companies adopt trading windows and black-out periods, with appropriate carve-outs and disclosures, for instance, by suggesting that companies should disclose when a director has been given a waiver to permit trading during a blackout period.

Should a more interventionist approach be adopted and, if so:

(a) how might that approach deal with the issues set out in Section 2.5.2

(b) should all or some of the requirements set out in the Model Code issued by the UK Financial Services Authority be adopted (Section 2.5.2)?

No, the Committee does not support a more interventionist approach. Further regulatory reform is not necessary for the reasons outlined above. The issues set out in Section 2.5.2 of the Issues Paper highlight the difficulties a more interventionist approach would encounter and provide support for the view that further regulatory reform is not appropriate. It is the view of the Committee that no international market has formulated a more effective legislative framework to deal with the issue of company directors trading during blackout periods.

4 Spreading false or misleading information

The Committee considers that there is a pressing need for a wholesale review of the existing provisions dealing with market manipulation in Division 2 of Part 7.10 of the Corporations Act.

To the extent that the current provisions apply to market disclosure and the dissemination of information, the provisions are overlapping and confusing. They are also inadequate for the prosecution of manipulative trading offences. They have failed to keep pace with changes in the market place. Section 1041E is derived from recommendations of the Rae Committee and section 73 of the Securities Industry Act 1970 (NSW). Section 1041F is derived from the Prevention of Fraud (Investments) Act 1958 (England) and is similar to section 1041E. All of these sections were enacted at a time when the trading floors in Australia were state based, open outcry. They therefore predated electronic trading of securities, mobile phones and the internet.

The complexity and inaptness of these provisions to market structure explain why there has been so little enforcement history in

Australia and no attempt has been made to resolve uncertainties derived from UK case law based on similar provisions as to the culpability basis of the sections.[3] Sections 1308 and 1309 also now cover very similar territory in a slightly different way.[4] The intersection with the civil remedy in section 1041H is also overlapping and confusing.

The Committee advocates the adoption of a single general antifraud sanction (to use US jargon) that applies to statements that relate to dealings in securities. This would be in the interests of simplification and clarification of this important policy underpinning of Australia's securities laws.

An important element of that debate is to fix a culpability requirement for the prohibition. The Committee would support a fraud standard for criminal liability and a negligence standard with a due diligence defence for civil liability.[5]

The Committee supports the extension of Part 9.4B civil penalty liability to these provisions for the reasons enunciated to support the introduction of that regime for certain sections specified in the Corporations Act.[6]

The Committee is also of the view that telephone recording will not work as an effective remedy to stamp out "rumourtrage" as rumourtrage will then merely take place outside dealing room floors. At best, telephone monitoring practices might operate as a disincentive to wrongdoing. However, this perceived enforcement benefit needs to be balanced against invasion of privacy, the cost of such intercepts and the often huge investigative resources taken up in reviewing hours of telephone taping product. There have been some public suggestions that telephone intercept powers should be given to ASIC in this area. While this might address some issues around the use of mobile telephones, the existence of prepaid telephones which are often difficult to trace makes this also a blunt instrument and magnifies the downsides addressed in relation to telephone taping.

5 Corporate briefings to analysts

The Committee does not consider that there is a need to greater regulate analysts briefings. Corporate briefings to analysts play an important role in Australia's finance market and, in the Committee's view, more information gets to the market as a result of analyst

[3] See the difference in approach between *R v Bates & Russell* [1952] 2 All ER 842, *R v Grunwald* [1953] 1QB 150 and *R v Mackinnon* [1959] 1QB 150. See also *Pollard v DPP* (1992) 8 ACSR 813. In the UK the uncertainty was resolved in 1963 by section 21 of the Protection of Depositors Act 1963 (England).

[4] Apparently derived from section 375 of the Companies Act 1961.

[5] This was broadly the recommendation of the Jenkins Committee in 1962 when reviewing the antecedent of section 1041F - see paragraphs 253-255 of Cmmd 1749.

[6] As enunciated in the recommendations of the 1989 Cooney Committee Report.

briefings then the market would otherwise receive in the absence of those briefings. While selective briefing has the potential to affect market integrity, the Committee considers that the continuous disclosure regime and insider trading laws, together with the actions of ASIC and ASX in producing guidance through *"Heard it on the Grapevine"* and *"Better Disclosure for Investors"* guidance, as well as ASX Guidance Note 8, supported by the ASX Corporate Governance Council's Principles and Recommendations are a sufficient regulatory response and are generally very well understood in the market.

It is the Committee's view that although telephone monitoring of private analysts' briefings may prove a disincentive against companies being selective in their disclosure of price sensitive information, this is a costly and problematic approach which will not stop the problem.

The CAMAC discussion paper makes reference to the operation of Regulation F-D (Fair Disclosure) in the United States. A provision such as Regulation F-D must be understood in the context of the US regulatory environment. Regulation F-D exists in circumstances where the insider trading sanction does not generally extend to information provided to market analysts.[7] Continuous disclosure requirements of US securities exchanges do not found private rights of action and are more limited than in Australia. The US background is therefore quite different.[8] On the other hand the Committee believes there is a proper policy basis in existing Australian law to properly regulate issues surrounding selective disclosure of material information to analysts as mentioned above. The Committee does not consider that recent experience of enforcement of these provisions reflects deficiencies that require legislative remedy.

5.1 Issues for consideration

Should there be greater guidance on what is required to ensure that the information provided in a public briefing is effectively and expeditiously disclosed generally?

No. It is the view of the Committee that sufficient guidance on disclosing information provided in analysts' briefings is already available to companies.

Should there 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?

No. It is the Committee's view that placing restrictions on when companies can conduct analysts' briefings or banning such briefings outright would do a disservice to the market. There are valid reasons for briefing market analysts, even during blackout

[7] See Dirks v SEC 463 US 646.

[8] For further discussion see Golding & Kalfus (2004) 22 C&SLJ 385.

periods, but companies must ensure they comply with all applicable disclosure requirements.

Are there any approaches to public or private briefings of analysts in overseas jurisdictions that could usefully be adopted in Australia?

No. It is the Committee's view that the regulatory framework and corporate governance guidelines currently in place in Australia sufficiently deal with corporate briefings to analysts.

Are there 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*

First, it is the view of the Committee that *more* information reaches the market as a result of analyst briefings than the market would otherwise get in the absence of those briefings, as highlighted above.

Second, as highlighted by the paper in section 4, there are already legislative prohibitions on providing certain information to analysts.

Whilst the Committee does not think it is necessary that the public be made aware of the timing of publication of a listed company's financial results, it would not oppose reform in this area.

6 Conclusion

It is the Committee's view that the Australian corporate regulatory regime has proved robust in recent market turbulence. The Committee therefore advocates changes only in those areas of the law that are ineffective and poorly drafted to suit their purpose: there is a pressing need for review of Division 2 of Part 7.10 of the Corporations Act.

If you have any queries or wish to pursue any of the matters raised in this response to the CAMAC discussion paper, please contact Greg Golding, Chair of the Corporations Committee on (02) 9296 2164.