Australian Government

Corporations and Markets Advisory Committee

ASPECTS OF MARKET INTEGRITY

Report

June 2009

Corporations and Markets
Advisory Committee

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30 June 2009

The Hon Chris Bowen MP
Minister for Financial Services, Superannuation and Corporate Law
Parliament House
CANBERRA ACT 2600

Dear Minister

I am pleased to present a report by the Advisory Committee on *Aspects of Market Integrity*.

The report responds to a request in November 2008 from Senator the Hon Nick Sherry, then Minister for Superannuation and Corporate Law.

Yours sincerely

Richard St. John
Convenor

Contents

1 Introduction

This chapter sets out the terms of reference, describes the review process and outlines the approach taken in the report on the four issues relating to market integrity on which the Advisory Committee's advice was sought.

1.1 Reference to the Committee

In a letter of 19 November 2008 (set out in Appendix A), the then Minister for Superannuation and Corporate Law, Senator the Hon Nick Sherry (the Minister), sought advice from the Corporations and Markets Advisory Committee (CAMAC) by 30 June 2009 on the effect of a number of practices on the integrity of the Australian financial market. The Minister stated:

> As a result of the global financial crisis and the related turbulence in Australian financial markets, the effect on the market of a number of practices has given rise to a significant degree of concern in the business, and broader, community.
>
> I am concerned that the lack of transparency and accountability surrounding some of these practices could mean that there is potential for damage to the integrity of the market and investor confidence.
>
> It is important to ensure that Australia's system of corporate law and regulation is sufficiently robust to provide investors with confidence that they are able to make fully informed decisions. I therefore seek CAMAC's advice on the corporate law aspects of the matters set out in this letter.

The Minister requested advice from CAMAC in relation to the following practices:

- directors entering into margin loans over shares in their company
- trading by directors in 'blackout' periods

- spreading false or misleading information
- corporate briefing of analysts.

1.2 The review process

Issues Paper

CAMAC published an issues paper in February 2009 and invited comment from interested parties. The paper provided background material on the four matters in the terms of reference, analysed the current legal position in Australia, referred to approaches in other countries and identified a series of issues for consideration.

Submissions

CAMAC received submissions from:

- Allens Arthur Robinson
- Australasian Investor Relations Association Ltd
- Australian Bankers' Association Inc.
- Australian Employee Ownership Association
- Australian Financial Markets Association
- Australian Institute of Company Directors
- Australian Securities and Investments Commission
- Australian Securities Exchange
- Australian Shareholders' Association
- Business Council of Australia
- Chartered Secretaries Australia
- Corporations Committee, Business Law Section, Law Council of Australia
- CPA Australia, the Institute of Chartered Accountants in Australia & the National Institute of Accountants

- David Morrison, University of Queensland
- Financial Services Institute of Australasia
- HopgoodGanim Lawyers
- Investment & Financial Services Association
- Janet Austin, University of New South Wales
- Jason Harris, University of Technology, Sydney
- Jim Berry
- Juliette Overland, University of Sydney
- Michael Legg & Alex Steel, University of New South Wales
- Michael Adams & Marina Nehme, University of Western Sydney
- Regnan
- RiskMetrics
- Securities & Derivatives Industry Association.

Reference is made to these submissions in the following chapters. The submissions are available on the CAMAC website and a collated version is published in conjunction with this report, under 'Reports' at **www.camac.gov.au**

The Advisory Committee was greatly assisted in its consideration of the issues by the information and views provided in these responses. The Committee expresses its appreciation to respondents for their contributions.

Overseas inquiries

Inquiries were pursued in a number of overseas jurisdictions to assist in the comparison of the position in Australia with overseas regulation, as called for by the terms of reference.

The Advisory Committee very much appreciated the preparedness of people who were approached to provide information and share perspectives on relevant matters. It acknowledges with appreciation the assistance provided by those contacts, including the following:

Canada

- Eleanor Fritz, Director, Compliance & Reporting, Advisory Affairs, Toronto Stock Exchange
- Ilana Singer, Senior Advisor, International Affairs, Paul Hayward, Senior Legal Counsel, Corporate Finance Branch and Daphne Wong, Analyst, International Affairs, Ontario Securities Commission
- Margaret McNee, Partner, and Jason Chertin, Associate, McMillan LLP, Lawyers

Hong Kong

- Ada Chung Lai-ling, Registrar of Companies, Karen Ho, Deputy Principal Solicitor, Elizabeth Mo, Deputy Principal Solicitor, and Anna Goodman, Senior Solicitor, Legal Services Division, Companies Registry
- John CY Leung, Deputy Secretary, and Grace Kwok, Principal Assistant Secretary, Financial Services and the Treasury Bureau
- Charles R Grieve, Senior Director, Corporate Finance, Securities and Futures Commission
- Chee Keong Low, Associate Professor in Corporate Law, The Chinese University of Hong Kong; Ashley Alder, Head of Asia, Herbert Smith; John Brewer, Barrister-at-Law; David M Webb, Editor, webb-site.com

United Kingdom

- Nigel Boardman, Partner, Slaughter and May
- Paul Davies, Cassel Professor of Commercial Law, The London School of Economics and Political Science
- Eilis Ferran, Professor of Company and Securities Law, University of Cambridge

- Mike Knight, Manager, Company Monitoring, Markets Division, Raheel Ilyas and Stephen Hanks, Wholesale & Prudential Policy, Financial Services Authority

- Jane McAloon, Group Company Secretary and Andre Liebenberg, Vice President, Investor Relations, BHP Billiton

- David Styles, Assistant Director, Corporate Law & Governance, Department for Business Enterprise & Regulatory Reform

United States of America

- James F Duffy, Interim Chief Executive Officer, NYSE Regulation and John Carey, Chief Counsel—U.S. Equities, NYSE Euronext

- Paul M Dudek, Chief, Office of International Corporate Finance, Robert Kaplan, Assistant Director, Division of Enforcement, Anthony S Kelly, Attorney, Division of Enforcement, and Shauna Steele, Branch Chief, Regulatory Policy, Office of International Affairs, Securities and Exchange Commission

- John C Coffee Jr, Adolf A. Berle Professor of Law, Columbia University Law School

- Donald Langevoort, Thomas Aquinas Reynolds Professor of Law, Georgetown University Law Center.

1.3 Terminology

The terms noted below are used in this report with the following meanings.

Companies

This report deals with the issues concerning the integrity of the Australian financial market. It focuses on market conduct concerning, or affecting, listed entities. References to companies in the recommendations therefore apply to these entities and are not directed at proprietary companies or other unlisted entities.

Dealing in securities

The term ‘dealing’ in relation to securities of a company is intended to have a broad meaning to cover any means by which a person obtains, or grants, an economic interest in those securities. It includes:

- acquisitions or disposals of securities
- transactions involving derivatives over those securities
- financial arrangements involving those securities, including using those securities as collateral through granting a charge, lien or other encumbrance over them.

Executive officer

The CAMAC report *Corporate duties below board level* (April 2006) noted that prior to amendments in 2000, the corporations legislation employed the term 'executive officer' to cover anyone who 'is concerned in, or takes part in, the management' of the company.[1]

This report uses the term 'executive officer' with this meaning. Generally speaking, this term would cover corporate officers reporting to the chief executive officer or otherwise constituting the top executive management group.

A comparable definition is found in the UK Model Code, which uses the term 'persons discharging managerial responsibilities' (PDMRs). This includes a senior executive of a company, defined as anyone who:

- has regular access to inside information relating, directly or indirectly, to the issuer, and
- has power to make managerial decisions affecting the future development and business prospects of the issuer.

1 Sections 3.2.7 and 3.2.8 and the discussion of the repealed 'executive officer' test.

1.4 Outline of report

1.4.1 Context

The integrity of the financial market and investor confidence in that market are critical elements in our economic well-being. The credibility of the market is underpinned by our system of corporate law and regulation. Maintenance of that integrity and credibility is of the highest importance for companies, investors and other market participants and for the community more broadly.

The Committee was asked to consider some particular market practices that have given rise to concern. While concern may be heightened at a time when the market has been under pressure and confidence has been shaken, those practices raise issues of ongoing relevance.

The purchase of securities by way of margin lending gained public attention following the recent marked decline that took place, in Australia and elsewhere, in the market price of quoted securities, resulting in an increased level of margin calls on borrowers under these lending arrangements. In a number of cases, directors and executive officers who had funded their stake in a company through margin loans were placed under pressure or forced to sell at a time not of their own choosing. Sales in these circumstances can have the effect of further depressing market prices.

Trading by directors or executive officers in the securities of a company during sensitive periods, such as between close of the company’s books and release of financial results, raises concerns about whether these individuals are trading, or may be trading, with an informational advantage not available to the market generally.

The spreading of false or misleading information in the market through rumour-mongering can take place at any time, but is of particular concern where there is significant market uncertainty and price volatility, as has occurred recently on Australian as well as other markets.

The practice by which companies provide briefings to analysts from time to time, while aiding the dissemination of information, can raise questions about whether some individuals may gain an informational advantage over the market generally, which they may use in trading.

1.4.2 Chapters 2 and 3

The Committee was asked to consider the entry by directors into margin lending arrangements involving the securities of their company and also trading by them in the company's securities during blackout periods.

The Committee considers that the issues arising in relation to these types of arrangements or transactions by directors also apply to the most senior executives (referred to in this report as 'executive officers') of a company. These individuals should be subject to similar duties and constraints, given their privileged position as key corporate insiders.

Also, the issues relating to the use of margin loans by directors and executive officers, and trading by them during sensitive periods in the reporting cycle of a company (blackout trading), are part of the wider issue of the appropriate regulation of dealings by directors and executive officers, at whatever time and in whatever form, in the securities of their company.

The Committee's recommendations on margin lending and blackout trading are cast in this broader context.

The Committee does not consider that there is any warrant for prohibiting directors and executive officers from entering into margin lending arrangements concerning the securities of the company. However, some level of control over dealings by directors and executive officers in the securities of the company, including through the use of margin loans, is called for.

The Committee recommends that, as a matter of best practice, directors and executive officers should only be permitted to deal in the securities of their company (including entering into margin lending arrangements involving those securities) with the prior clearance of the board, or some person designated by the board. Some exceptions should apply where prior approval is not warranted. The clearance processes could be implemented as a governance measure through the ASX Corporate Governance Council *Corporate Governance Principles and Recommendations* or in the ASX Listing Rules. In the absence of effective implementation in a governance context, a legislative response might be considered.

The Committee also recommends strengthening the market disclosure requirements where dealings have taken place, by requiring more timely public disclosure by directors and executive officers of entry into them.

The Committee recommends some tightening of the insider trading provisions so that they apply to lenders and borrowers under margin lending and other financial arrangements in the same manner as to all other market participants. Parties to these financial arrangements should not be in a privileged position under the insider trading laws and should take those laws into account when entering into these arrangements.

The Committee also recognises that transacting in the securities of a company for legitimate needs can pose difficulties for responsible directors, executive officers and other corporate insiders, who may be constrained from trading for long periods through their exposure to inside information. The Committee reiterates the recommendation it made in an earlier report that dealings under non-discretionary trading plans should be permitted as an exception to the insider trading provisions, as in other jurisdictions. This will allow a corporate insider to adjust his or her portfolio in the securities of the company through transactions entered into on that person's behalf from time to time to meet regular or anticipated financial commitments or objectives, without the transactions being impeded by the possibility that the insider holds inside information.

These recommendations are set out in Section 2.9 of the report.

The Committee also recommends that, as a matter of best practice, directors and executive officers should be prohibited from transacting in the securities of their company in the period between the close of a company's books and release of its half-year or full-year results, and at other sensitive times when the company has under consideration some confidential market-sensitive transaction or development (blackout periods). There should be provision for some limited exceptions.

This prohibition on trading during blackout periods could be implemented as a governance measure through the ASX Corporate Governance Council *Principles and Recommendations* or in the ASX Listing Rules. In the absence of effective implementation in a governance context, a legislative response might be considered.

These recommendations are set out in Section 3.6 of the report.

1.4.3 Chapter 4

The Committee was asked to review the spreading in the market of false or misleading information (rumour-mongering).

Rumour-mongering raises issues concerning:

- the regulatory response to the perpetration of false rumours
- how companies faced with rumours about them might respond
- how market participants respond to rumours received.

There is already a range of statutory prohibitions and offences relevant to the perpetration of false rumours or other forms of market manipulation. While some review and rationalisation of these provisions would be useful, there does not appear to be an obvious gap in their application that calls for immediate response. Having said that, as a practical matter it can be difficult to track down the instigators of rumours and there are challenges in the way of effective investigation and enforcement.

The Committee recommends various measures to strengthen the means available to ASIC to detect and respond to rumour-mongering, including the introduction of civil penalties for some key market misconduct provisions and requiring market licensees to have guidelines on rumour-mongering and to report any suspected misconduct. In view of the potentially serious consequences of market manipulation, the possible use of telephone interception should be open as an adjunct to law enforcement in this area, as it is with other serious offences.

The Committee encourages ASIC, the ASX and various industry bodies further to develop appropriate guidance to assist companies in deciding how best to respond to rumours about them.

The Committee also supports an ASIC initiative to develop best practice guidelines on how to respond to rumours received.

These recommendations and comments are set out in Section 4.6 of the report.

1.4.4 Chapter 5

The Committee was asked to consider the regulation of the practice by which companies provide briefings to analysts.

Briefings can provide a useful supplement to formal disclosures by companies and help promote a more informed and efficient market, provided that they comply with relevant regulatory requirements, including the prohibition on insider trading.

It is in the interests of a well-run company to control its communications with analysts and others concerning its affairs. There is an opportunity for the ASX Corporate Governance Council to build on existing guidance by introducing recommendations in its *Principles and Recommendations* to encourage more open practices in relation to briefings, including making them more accessible where possible, maintaining a record of their key aspects and restraining their use during times of market sensitivity.

These recommendations and comments are set out in Section 5.8 of the report.

1.5 Advisory Committee

The Advisory Committee is constituted under the *Australian Securities and Investments Commission Act 2001*. Its functions include, on its own initiative or when requested by the Minister, to provide advice to the Minister about corporations and financial services law and practice.

The members of the Advisory Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their knowledge of, or experience in, business, the administration of companies, financial markets, financial products and financial services, law, economics or accounting.

The current members of the Advisory Committee are:

- Richard St John (Convenor)—Special Counsel, Johnson Winter & Slattery, Melbourne
- Zelinda Bafile—Lawyer, Director and former General Counsel and Company Secretary, Home Building Society Ltd, Perth

- Jeremy Cooper—Deputy Chairman of ASIC or Belinda Gibson—Commissioner of ASIC, as nominee of the ASIC Chairman
- Ian Eddie—Professor of Accounting, School of Commerce and Management, Southern Cross University, Tweed Heads
- Alice McCleary—Company Director, Adelaide
- Marian Micalizzi—Chartered Accountant, Brisbane
- Geoffrey Nicoll—Co-Director, National Centre for Corporate Law and Policy Research, University of Canberra
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler—Partner, Blake Dawson, Sydney
- Greg Vickery AM—Chairman and Partner, Deacons, Brisbane
- Nerolie Withnall—Company Director, Brisbane.

A Legal Committee provides expert legal analysis, assessment and advice to the Advisory Committee in relation to such matters as are referred to it by the Advisory Committee.

The members of the Legal Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their expertise in corporate law.

The current members of the Legal Committee are:

- Nerolie Withnall (Convenor)—Company Director, Brisbane
- Lyn Bennett—Partner, Hunt & Hunt, Darwin
- Elizabeth Boros—Professor of Law, Monash University, Melbourne
- Damian Egan—Partner, Murdoch Clarke, Hobart
- Jennifer Hill—Professor of Law, University of Sydney
- James Marshall—Partner, Blake Dawson, Sydney

- David Proudman—Partner, Johnson Winter & Slattery, Adelaide
- Simon Stretton—South Australian Crown Solicitor, Adelaide
- Gabrielle Upton—Legal Counsel, Australian Institute of Company Directors, Sydney
- Rachel Webber—Special Counsel, Jackson McDonald, Perth.

The Executive comprises:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Thaumani Parrino—Office Manager.

2 Margin lending

This chapter discusses arrangements by which directors and executive officers use their shares in the company as collateral for borrowings. It considers the current legal position, including possible conflict of interest and insider trading issues, as well as disclosure requirements. It looks at the approach of other countries. It considers whether further regulation is warranted. It recommends corporate approval processes in accordance with best practice for margin lending and other dealings by directors and executive officers in the securities of their company, as well as amendments to the statutory disclosure requirements to ensure an informed market. Some changes in relevant aspects of the insider trading laws are also proposed.

2.1 The Minister's request

The Minister said in his letter that:

> there may be a significant adverse impact on the market price of a company's shares where a director is required to divest large parcels of shares as a result of a margin call.

In an accompanying media release, the Minister noted that:

> Concerns have been expressed about the adequacy of disclosure to the market of directors' margin lending arrangements and uncertainty remains as to the nature of directors' obligations to disclose both to their boards and to the market—we need to clear this up once and for all.[2]

The Minister's letter also states:

> Better disclosure to the market will improve the ability of market participants to assess the risk of divestiture of material shareholdings by directors. However, some commentators have suggested that the provision of specific details of loan arrangements, such as trigger prices, may

2 *Media Release*, 19 November 2008.

> encourage market manipulation by short sellers of the company's stock.
>
> The frequency, nature and extent of any mandatory disclosures may also impact on the regulatory burden imposed on companies. Generally, greater disclosure increases the costs and complexity of compliance. Improving the clarity and certainty of the test to be applied in determining whether disclosure is required may reduce complexity, the costs of compliance, and costs resulting from erroneous non-compliance.
>
> The current regime should also be assessed in terms of the effect on directors as well as on the company itself. Rules that impose costs upon directors may act as a disincentive to directors acquiring a material shareholding in companies which employ them. The extent to which any rules require the disclosure of the personal affairs of directors or their associates may have a similar effect.

The Minister asked the Advisory Committee to:

- compare overseas regulation of the disclosure of directors' shareholdings subject to margin loans or similar funding arrangements with that of Australia
- advise whether any, and if so what, changes are required to Australia's regulatory framework.

2.2 Concept of margin lending

In general terms, margin lending covers any arrangement, by way of a pledge, mortgage, lien, charge or other encumbrance, under which securities in a company are provided by a borrower as collateral for a loan taken out by the borrower (to acquire the shares or for some other purpose), with a right for the lender to require the borrower to maintain the value of that collateral at a certain percentage of the value of the loan. The lender can enforce that requirement typically through a margin call (to pay off some of the debt or increase the value of the collateral) if the value of the securities falls below a certain level, and with a further right to sell the securities if the borrower fails to honour the margin call.

Margin loans may be undertaken by any shareholder, not just a director or executive officer.

The Minister's letter referred to the practice of margin lending as follows:

> Margin lending refers to the practice of providing loans that are secured over an asset held by the borrower, with a condition that if the ratio of the asset's market value to the amount of the loan falls below an agreed level, the borrower may become subject to a 'margin call'. If this occurs the borrower must reduce the level of indebtedness or increase the value of the security pledged, commonly by selling part of the security to pay down the loan. Margin loans are commonly utilised to enable investors to acquire financial products which are then used as the collateral.

Further details of margin lending were provided in an earlier Treasury Green Paper:

> Margin lending describes an arrangement under which investors borrow money to buy financial products (such as listed shares, fixed interest securities and units in managed funds). The underlying financial products are then used to secure the loan for those products. As with most other loans, investors must pay interest on the amount borrowed under a margin loan. Margin loan facilities are based on contractual arrangements between the lender and the client. Primary disclosure of the terms and conditions governing the loan occurs through the lending agreement signed between the two parties.
>
> Repayments for the loan may be required if the investment is subject to a 'margin call'. This occurs where the market value of the investment falls below the level agreed under the contract. This could be caused by a fall in the value of the investment or if there is a significant fall in the market. A margin call requires the investor to increase the level of assets securing the loan to return the portfolio to the agreed limits stated under the contract. This can be done by paying extra cash, selling some of the assets or giving the lender additional security. The lender is under no obligation to contact the investor when a margin call is made. The responsibility falls on the investor to increase the asset level as security in accordance with the time line set out in the margin loan agreement.
>
> The amount an investor can borrow depends on the loan-to-valuation ratio (LVRs) offered by a lender for each

> stock. This can vary from as low as 30 per cent to as high as 90 per cent. Stocks that are deemed to be low risk will have higher LVRs, and the investor is able to borrow more.[3]

2.3 The issues

Directors of a public company commonly hold securities in their company. In some cases, as where a director was a founder of the business, this personal stake may be substantial. While the practice by which directors were required, under the constitution of a company, to hold a certain number of shares by way of qualification has become less common, as a matter of policy, many companies encourage their directors to build up their holdings of shares in the company. A personal financial involvement of this nature may be seen as a means of aligning the interests of directors with those of other shareholders.[4]

In practice, directors fund the acquisition of the company's securities in various ways. Some companies adopt a practice by which part of the fees drawn by directors are allocated to the acquisition of securities. Directors have also financed their acquisitions of securities through various lending arrangements, including margin lending. Margin lending allows directors to use their securities in the company as collateral for the loan, subject to conditions under which the lender is entitled to make a call on the loan if the ratio of the value of the securities to the amount of the loan declines below a specified figure or to sell the securities in circumstances of default.

The use of margin loans by directors raises issues concerning:

- possible conflicts between their self-interest under the loan arrangement and their fiduciary duties to act in the best interests of the company

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3 *Financial Services and Credit Reform: Improving, Simplifying and Standardising Financial Services and Credit Regulation* (June 2008) at 27.

4 For instance, IFSA Guidance Note No. 2.00 *Corporate Governance: A Guide for Fund Managers and Corporations* (2009), Guideline 11 states:

> The board should establish and disclose in the annual report a policy to encourage non-executive directors to invest their own capital in the company or to acquire shares from an allocation of a portion of their fees.

- the adequacy of disclosure to the company, and to the market, of these loan arrangements.

From the perspective of the market, the significance of margin lending arrangements lies in the possibility of securities in the company being sold, either by the borrower or by the lender, if the market price of the company's securities declines below a level required to provide adequate collateral for the loan, and the implications of these sales for the market price of the company's securities.

Whether or not a borrower will be forced to sell securities in a particular case may, of course, depend on the borrower's overall financial circumstances.

The size of the relevant shareholding of the director will, of course, be relevant to any market impact of a forced sale.

A lack of information in the market about relevant borrowing arrangements by a director can also give a misleading impression of that person's stake in the company:

> While granting security over shares is not equivalent to purchasing or selling those shares, it can indicate a significant change in the level or nature of the commitment of a PDMR [director or other person discharging managerial responsibilities] to the company. Where a PDMR is known by the market to have a significant shareholding and the market does not know that those shares are pledged to finance other activities, regard might be had to the shareholding on the basis of an incorrect estimation of its significance.[5]

The terms of reference focus on the position of a director who is a borrower under a margin loan arrangement. However, the Committee considers that similar issues can arise where any person who is in a position of influence or control in a company has entered into margin lending arrangements. The Committee has therefore extended its review of margin lending to cover margin loans to executive officers.

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5 Financial Regulator (Ireland), *Disclosure of Grants of Security over Shares* (Consultation Paper CP 36 2009) at 1.

The Committee is also of the view that the issues in relation to margin lending, as it applies to directors and executive officers, are part of the broader question of the appropriate regulation of all dealings by those persons in the securities of their company.

A related issue, which is the subject of separate legislative initiatives, concerns the duties of the lender under a margin lending arrangement.[6]

2.4 Entry into margin loans

While there is no prohibition on directors or executive officers entering into margin loans as such, there can be questions about the compatibility of such loans with the duties of those persons to their companies and to the implications for the market if those persons were forced to sell their securities at a time not of their choosing.

2.4.1 Current position

Duties of directors

Depending on the circumstances (including the size and terms of the loan and the overall financial position of the borrower), directors with margin loans over securities that they hold in the company may face conflicts of interest between their personal exposure under the lending arrangements and their common law and statutory duties to the company.[7] A director may feel under undue pressure to support the market price of the securities in the short term, having regard to the exigencies of personal margin loan arrangements. A director with a margin loan may also be concerned that the disclosure of negative corporate information by the company could reduce the market price of the securities and thereby trigger a margin call.

Insider trading laws

A director or other person in possession of inside information concerning a company[8] is prohibited from transacting in the

6 The Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009, if enacted, may significantly limit the circumstances in which margin loans are made to directors.

7 These duties are summarised in the CAMAC report *The social responsibility of corporations* (December 2006) Sections 3.2 and 3.3.

8 The concept of 'inside information' is defined in s 1042A.

company's securities while that information remains confidential.[9] That person has no defence that the trading was in response to a pressing financial need, that the person decided to trade for reasons other than reliance on the inside information or that the trading was contrary to the inside information (for instance, where the information indicated that the securities were underpriced when they were sold).[10]

Also, persons who hold inside information are prohibited from 'procuring' anyone else to transact in those securities.[11] There is a question whether, or in what circumstances, a sale of securities by a lender following the failure of a borrower to meet a margin call would amount to the procurement by the borrower of that sale.

It is noted that Corporations Regulations reg 9.12.01(e) provides that the prohibition on insider trading does not apply in relation to a 'sale of financial products under a mortgage or charge of the financial products'. This exemption would cover sales of securities by the lender, and possibly by the borrower, in consequence of a margin call on those securities.

ASX Corporate Governance Council

The ASX Corporate Governance Council *Principles and Recommendations* (2nd Edition) make no specific recommendations on margin lending to directors. However, Principle 3 and Box 3.1, concerning ethical and responsible corporate decision-making, and Principle 5 and Box 5.1, concerning timely and balanced corporate disclosure, may be of some general relevance to a company's approach to entry by their directors and executive officers into margin loan arrangements.

2.4.2 Other jurisdictions

United Kingdom

Margin lending in relation to the securities of UK listed public companies is regulated by the Model Code, issued by the UK

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9 s 1043A(1)(c).

10 See the CAMAC *Insider Trading Discussion Paper* (2001) paras 2.142–2.158 and the CAMAC *Insider Trading Report* (2003) paras 3.8–3.9.

11 s 1043A(1)(d). Procuring under the insider trading provisions is defined in s 1042F.

Financial Services Authority (FSA), which applies to all dealings by PDMRs in a company's securities.

The Model Code forms part of the listing rules.[12] The listing rules also state that a listed company must require every person discharging managerial responsibilities, including directors, to comply with the Model Code and to take all proper and reasonable steps to secure their compliance.[13] The FSA has various disciplinary powers against listed companies where any breach of the Model Code occurs.[14] A listed company may also impose more rigorous dealing obligations than those required by the Model Code.[15]

The Model Code was developed in consultation with exchange and market representatives. It focuses on perceptions of market abuse rather than actual behaviour.[16] The Model Code also makes clear that nothing in it sanctions a breach of the insider trading provisions or other relevant legal or regulatory requirements.

The general principle under the Model Code is that a director or other person discharging managerial responsibilities (PDMR):[17]

> must not deal in any securities of the company without obtaining clearance to deal in advance.[18]

Certain dealings are exempt from this requirement, including transactions pursuant to a rights issue, a dividend reinvestment or an

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12 The Model Code is set out in Annex 1 to Listing Rule 9 of the FSA Handbook.

13 Listing Rule 9.2.8.

14 As the Model Code is part of the listing rules, the FSA can only take disciplinary action against the company for a breach. This may range from informal processes, such as calling in one or more directors or other corporate officers to discuss a breach or imposing a private warning, to public censure, such as publishing a warning on the company's record of compliance or fining the company. Where a PDMR fails to obtain the prior consent of the company, the FSA, in appropriate circumstances, may pursue that individual for market abuse.

15 Listing Rule 9.2.9.

16 *FSA Handbook Notice 85* (February 2009) Section 4.51.

17 The Model Code requirements apply to any restricted person, meaning a 'person discharging managerial responsibilities' (see para 1(f)). This term covers directors and senior executives: see the Note to para 4 of the Model Code, referring to the *Financial Services and Markets Act 2000* (UK) s 96B(1).

18 Model Code para 3.

employee share scheme, an acceptance under a takeover offer, or where there is no change in the beneficial interest in the securities.[19]

Conversely, the power to grant a clearance is restricted, or prohibited outright, in regard to various dealings.[20]

A dealing is widely defined to include, for instance, any acquisition or disposal of, or agreement to acquire or dispose of, the securities of the company or 'any other right or obligation, present or future, conditional or unconditional, to acquire or dispose of any securities of the company'.[21] It also includes 'using as security, or otherwise granting a charge, lien or other encumbrance over the securities of the company'.[22] The FSA takes the view that this definition covers a PDMR using securities of the company as collateral for any financing transaction, including for a margin loan:

> [the FSA] can see no basis on which a director could have a legitimate excuse for not seeking clearance in advance where the company's securities are to be used as collateral for a financing transaction.[23]

The Code sets out the procedures for a PDMR to obtain from the company prior clearance to deal.[24] That person must not deal in the company's securities without first notifying the board (or a person designated for this purpose) and receiving a clearance to deal from that person. The Code leaves it to each company to determine its policy on granting permitted clearances.

The company must maintain a record of the response to any dealing request made by a restricted person and of clearances given.[25]

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19 para 2.

20 For instance, a clearance may not be given to a PDMR to transact in the securities of the company when there is inside information about the company or in the period before the release of financial information (both of which are relevant to blackout trading, as discussed in Chapter 3) or in relation to investments in the securities of the company by a PDMR 'of a short term nature': Model Code para 8, definition of 'prohibited period' in para 1(e), definition of 'close period' in para 1(a).

21 para 1(c)(vii). Securities are defined in para 1(g).

22 Model Code para 1(c)(v).

23 FSA, *Disclosure and Model Code obligations in respect of the use of shareholdings as security* (9 January 2009).

24 Model Code paras 4, 5.

25 Model Code para 6.

A person who is given clearance to deal, including using the securities of the company as collateral, must proceed with the transaction as soon as possible and in any event within two business days of clearance being received.[26]

The Model Code is set out in Appendix B.

USA

There is no prohibition as such on directors or other executives entering into margin loan or other financial arrangements concerning the securities of their company. However, there are restrictions on these persons borrowing from the company, including to fund a purchase of the company's securities.[27]

There are controls over the amount of funds that can be provided under margin loans. The Federal Reserve Board restricts the amount of money that may be lent or borrowed in connection with securities transactions to a certain percentage of the market value of the securities.[28] One possible effect of these regulations may be to reduce the chance of a forced sale of securities if a borrower is unable to meet a margin call.

Transactions by directors, or other officers, to acquire securities in their companies, however funded, are subject to the insider trading provisions, which apply to transactions in securities.[29] The Securities and Exchange Commission (SEC) takes the view that a sale of securities of the company held by the borrower, in consequence of a margin call or otherwise, and whether transacted by the borrower or the lender, generally constitutes a transaction in those securities by the borrower for the purpose of the insider trading laws.

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26 Model Code para 7.

27 Section 13(k) of the Securities Exchange Act of 1934, introduced by s 402 of the *Sarbanes-Oxley Act of 2002*.

28 Under the power conferred by s 7 of the *Securities Exchange Act of 1934*, the Federal Reserve Board has issued Regulation T (lending by broker-dealers), Regulation U (lending by commercial banks), Regulation G (lending by persons other than broker-dealers or banks) and Regulation X (borrowers from US or foreign lenders).

29 A detailed outline of the US law on insider trading is set out in Appendix 6 of the CAMAC *Insider Trading Discussion Paper* (2001).

This approach is reflected in the SEC interpretation of its Rule 10b5-1[30] (the principles of which the Advisory Committee has recommended be introduced in Australia[31]). The Rule permits persons with inside information to buy or sell financial products under non-discretionary trading plans, provided they devised these plans before becoming aware of the current inside information and they have no discretion to alter those plans, other than to terminate them.[32]

The SEC has indicated that transactions entered into in consequence of loan arrangements for the purchase of securities generally do not qualify for exemption under Rule 10b5-1 from the insider trading provisions, as:

- the borrower can usually exercise a discretion not to pay the loan, resulting in default and transfer or sale of the securities
- the borrower often has a discretion to substitute collateral or provide additional collateral or cash to prevent foreclosure and sale of the stock.

The SEC has also indicated that where, in response to a margin call, a person retains any discretion to substitute or provide additional collateral, or to repay the loan before the pledged securities may be

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30 SEC Rule 10b5-1 was introduced in 2000.

31 CAMAC *Insider Trading Report* (2003) rec 16.

32 As indicated in the CAMAC *Insider Trading Discussion Paper* (2001) Appendix 6, US Rule 10b5-1 does not require registration of the plan or regulate its period of operation or level of detail. However, to protect against possible abuse, the exemption from the insider trading provisions only applies where:

- the trading took place in accordance with a plan entered into when the person was not aware of any inside information
- there are no discretions under the plan, other than to terminate it (given that under US law, as under Australian law, any person with inside information may lawfully decide not to trade). A person could not activate a trading plan, or change its terms, during that time
- the plan was entered into in good faith and not as part of a scheme to evade the insider trading prohibitions. This would overcome the possibility of a person entering into a number of concurrent plans that have an overall neutral effect and subsequently terminating those plans that would not be profitable given later obtained inside information.

Issuers generally require a cooling-off period to make sure that transactions under the plan are not based on information held by the insider at the time the plan was adopted or amended.

sold, Rule 10b5-1 does not provide a defence to any charge of insider trading.[33]

Canada

There is no express prohibition on directors or executive officers entering into margin loans in Canada.

Insider trading laws may be applicable where directors or other officers in possession of material non-public information choose, or are forced, to sell their securities in the company in response to a margin call under a margin loan arrangement. Generally, directors of a reporting issuer may only buy and sell securities of that issuer if they do not have access to material undisclosed information at the time of the trade.[34]

There are exemptions from the Canadian insider trading prohibitions that could apply to directors or executive officers who are forced to sell securities of the company under a margin loan arrangement. For example, a person with inside information is exempt from the insider trading provisions of the Ontario *Securities Act 1990* where that person proves that:

> the purchase or sale was made to fulfil a legally binding obligation entered into by the person or company prior to the acquisition of knowledge of the material fact or material change …[35]

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33 Securities and Exchange Commission, *Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations Fourth Supplement.*

34 Ontario Securities Act R.S.O. 1990, (OSA) c. S.5, s 76(2) and OSA General Regulation 1015, s 175(2) (OSA General Regulation). See also *Multilateral Instrument 55-103—Insider Reporting for Certain Derivative Transactions (Equity Monetization)*, adopted by the Ontario Securities Commission and certain other members of the Canadian Securities Administrators. Canadian securities legislation includes a prohibition on anyone in a special relationship with a reporting issuer from purchasing or selling securities of the reporting issuer with the knowledge of a material fact or material change with respect to the reporting issuer that has not been generally disclosed: OSA, s 76(1) and s 3.1 NP 51-201. The term ‘person in a special relationship with a reporting issuer’ is defined to include, among other things, ‘a person who is a director…of the reporting issuer’: OSA, s 76(5). The term ‘insider’ is also defined to include directors of reporting issuers and directors of a company that is an insider or subsidiary of a reporting issuer: OSA, s 1(1). The Canadian insider trading provisions apply to both undisclosed material facts and material changes.

35 s 175(2)(c) of the OSA General Regulation.

2.4.3 Matters for consideration

The Issues Paper raised a series of questions and policy options concerning whether margin loans to directors should be prohibited, restricted, or subject to further regulation in some manner.

These matters, and a summary of responses in submissions, are set out below.

1 Whether margin loans to directors should be prohibited

The legislation could prohibit directors from entering into margin loan arrangements related to their shares in the company.

This option would overcome the potential for conflicts of interest to arise between the personal interest of a director who has a margin loan and that person's duty to act in the best interests of the company. At the same time, it would limit the means by which directors could finance the acquisition of the company's shares.

One submission advocated a prohibition on directors taking out margin loans involving the shares of the company, referring to adverse effects on the company and its share price when margin calls are made and conflicts of interest and duty that can arise for directors who have these loans. It argued that:

- the liquidation of large director shareholdings in consequence of margin calls drives share prices down to artificially low and damaging levels
- investors may drive down a company share price to trigger a margin call against large director shareholdings and profit from the resulting short-term price drops
- even temporary price drops (or the threat of price drops) resulting from margin calls on large director shareholdings can trigger or contribute to events that cause lasting damage to a company, for instance:
  - investor confidence in a company's directors and/or management may fall if investors feel that senior executives or directors give priority to their own finances over the best interests of the company by allowing margin calls to be made against them or are reckless in their personal financial affairs

- banking covenants may be triggered if a company's share price drops below a certain level

- margin loans to directors may compromise their ability to comply with their fiduciary duty to act in the best interests of the company by providing an incentive to manage the share price upward to avoid a margin call (in particular, by affecting a director's willingness to disclose negative information and enthusiasm for disclosing positive information), regardless of the size of the share parcel. Other investors do not have the same fiduciary duty

- margin loans to directors raise insider trading issues:

  - the possibility that the directors themselves may initiate sales resulting from margin calls

  - the possibility that some directors may talk down the share price to trigger margin calls, allowing them to exit their exposure to the company without having to take responsibility for the sale.

However, the thrust of views of respondents was against an outright prohibition on margin lending to directors, or other officers, referring to the benefit to shareholders generally of these officers having an equity interest in the company, even if funded through margin lending arrangements.

Submissions argued that margin lending had the following advantages:

- it provides funds for corporate growth, especially for smaller companies and those expanding rapidly and heavily reliant on funding from promoters, and enables founding directors to maintain significant shareholdings when the capital base of their companies has grown

- it may assist in aligning the interests of directors and senior executives with those of their companies by facilitating the funding of share acquisitions by those persons

- margin loans are a long-established practice that can benefit directors as part of an investment strategy

- the ability to use shareholdings in the company as security to obtain loan finance enables directors and officers to diversify their risk by using the funds for other investments.

While supportive of directors having a right to take out margin loans, some respondents nevertheless identified possible problems that may arise with margin lending:

- it may produce conflicts of interest between a director’s personal financial affairs and the interests of the company, including:
  - a personal interest in maintaining the security price at a certain level to avoid a margin call
  - a reluctance to disclose to the market details of margin loan arrangements or information that may depress the price of the company’s securities
- it may reduce confidence in a company and market confidence through:
  - heavy selling of securities (which becomes self-perpetuating in a falling market) as a result of margin calls
  - a perception that the interests of directors and senior executives are not fully disclosed
  - the possibility that a margin call can require directors and senior executives to sell, even when they have confidential price-sensitive information.

2 *Whether the right of directors to enter into margin loans should be restricted*

Another approach is to restrict the right of directors to enter into margin loans, for instance, by requiring them to demonstrate financial capacity to repay the loan without resort to sale of the pledged securities.

Recent legislative initiatives seek to regulate the capacity of lenders to provide margin loans by requiring that they assess the ability of the prospective borrower to repay the loan.[36] This may reduce the number of loans provided.

3 Whether there should be further regulation of the process of entry by directors into margin loans

Various views were advanced in submissions on the four policy options set out in the Issues Paper.

(a) Voluntary approach

Under this approach, it would be left to the discretion of each company:

- whether the company needs to have a policy on the entry into margin loans by its directors and executives
- if so, the content of that policy, including any prohibitions on such loans or conditions on entry into such loans.

The Investment and Financial Services Association (IFSA) and the Australian Council of Superannuation Investors (ACSI) have said that companies should have defined policies on directors and senior

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[36] The Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009, if enacted, may significantly limit the circumstances in which margin loans are made to directors.
Unless a director is a wholesale client, the effect of the legislation on margin loans to directors will be that:
- before issuing a margin lending facility to the director, a financial services licensee must assess whether the facility will be unsuitable for the director if the facility is issued (ss 985E, 985F; a financial services licensee must make reasonable inquiries about a retail client's financial situation: s 985G)
- in particular, the margin lending facility will be unsuitable if, at the time of the assessment, it is likely that the director will be unable to comply with a margin call or only able to do so with substantial hardship (s 985H)
- the financial services licensee must not issue the margin lending facility to the director if the facility would be unsuitable for the director (s 985K).

These requirements will be civil penalty provisions and failure to meet the third requirement will also be an offence.
Situations where a director will be a wholesale client, and therefore not affected by the above requirements, include:
- where the amount of the margin loan exceeds $500,000 (s 761G(7)(a), Corp Regs 7.1.18–7.1.19)
- where the director has net assets of at least $2.5 million or a gross income for each of the last 2 financial years of at least $250,000, as certified by a qualified accountant (s 761G(7)(c), Corp Regs 7.1.28).

executives trading and exposures in their company's securities.[37] The IFSA Blue Book (2009) provides guidance for companies concerning entry by directors and other executives into margin lending or other lending arrangements over the company's securities.[38] Also, the circumstances of various recent corporate collapses may have encouraged more companies to develop their own policies about entry into margin loans and disclosure of these loans to the company.[39]

Arguments for a voluntary approach

Arguments put forward in submissions for a voluntary approach include:

- each company is best placed to develop risk management strategies to deal with the possible effects of margin loans to directors on its credibility

- the incidence of directors taking out margin loans over a significant proportion of the company's securities has receded and directors' security holdings are often not material

- imposing prescriptive legislative regulation on margin loans may create a significant disincentive for directors to purchase shareholdings in the company, thus detracting from the alignment of the directors' interests with those of the company and shareholders generally

- prescriptive legislative regulation may impose additional costs and administrative burdens on companies without any clear benefit

- there is no evidence that most directors are abusing margin loans or that margin loans are bad for the stock market or individual corporate entities

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37 Joint statement 28 March 2008, reaffirmed by IFSA in its response to the Treasury Green Paper *Financial Services and Credit Reform: Improving, Simplifying and Standardising Financial Services and Credit Regulation* (June 2008).

38 IFSA Guidance Note No. 2.00 *Corporate Governance: A Guide for Fund Managers and Corporations* (2009), Guideline 12.

39 T Poisel and A Terret, *Transparency and disclosure: Implications of the bear raid on ABC Learning Centres* (2009) 27 C&SLJ 139 at 151.

- regulation may require disclosure of the personal affairs of directors

- the current rules concerning directors' duties and market disclosure suffice.

Possible approaches in company policies

There are various approaches that a company policy might take, including:

- *a self-assessment approach:* the policy could permit directors to enter into margin loans, without their having to seek the company's approval, provided certain conditions stipulated in the policy are satisfied

- *a company approval approach:* the policy could require directors to seek the company's approval before entering into margin loans and set out the factors that the company will take into account in determining an application. The company policy could also prohibit the holding of the company's shares in a margin account altogether or in some circumstances.

Whatever approach is taken for entry into a margin loan might also apply to any material changes to existing margin loan arrangements.

The types of factors mentioned in submissions that companies might take into account in determining the content of their margin lending policy or the way in which it would operate include:

- the company's circumstances

- particular features of the proposed margin loan

- the proportion of the company's securities over which the margin loan is secured must not be so significant that the continuous disclosure obligation might be triggered

- the director can clearly demonstrate the financial capacity to repay the loan without resort to a sale of the pledged securities

- whether the proposed loan could lead to concentrated selling of the company's securities in a market downturn and, if so, the consequences for the company

- the effect on the company if the loan had to be disclosed to the market as material information under Listing Rule 3.1
- any need for restrictions on loan terms, for instance loan to valuation ratio (LVR) exposure or the total equity that may be exposed per individual and amongst all senior executives collectively, particularly where the holdings and/or exposures are material
- managing trigger points for margin calls or forced sales.

Publication of company policies

Some submissions proposed that any board policy on margin lending should, as a matter of best practice, be posted on the company's website.

(b) Amend the Corporate Governance Principles

Some respondents argued that the ASX Corporate Governance Council *Principles and Recommendations* could be expanded beyond what is currently found under Principle 3, including Box 3.1, to include either:

- a statement that companies should have a policy on directors and others taking out margin loans, though each company could determine the contents of that policy, including any restrictions or conditions on entering into loans, or
- a statement that companies should have a policy on directors and others taking out margin loans, together with specific guidelines on matters that companies could include in that policy (which could include some of the suggestions put forward under ***(a) Voluntary approach***, above), or
- a statement that companies should have a policy requiring directors to obtain prior consent to a margin loan arrangement and a list of the grounds for granting consent that the policy should contain

though companies could take a different approach under the 'if not, why not' reporting requirements.

In relation to each option, there is a further question whether the details of the policy should be publicly disclosed.

(c) Legislative requirement for companies to have a margin lending policy

One view was that listed companies should be obliged by legislation to have an internal policy regulating margin loans to directors:

- to assist the company in meeting its external disclosure obligations and dealing with potential conflicts of interests
- to assist the regulator in investigating trades by company directors for potential insider trading and market manipulation.

This internal policy should be disclosed as part of the periodic disclosure obligations in ASX LR 4.10.

It was argued that the content of the policy should remain a matter for the company, as:

- the corporation is the most appropriate body to determine the appropriate balance between the desirability of directors being able to enter into margin loans and the ramifications of the company having to disclose a margin loan arrangement or similar facility under ASX LR 3.1
- externally imposed controls may not be beneficial, as various factors determine whether margin loans or other relevant facilities are material to the market assessment of a company's securities, including:
  - the number of securities held by the individual
  - the proportion of those securities that are subject to the relevant facility
  - the trading volumes in the company's securities
  - whether the company's security holders are dispersed or concentrated
  - the company's capital structure.

(d) Legislative or listing rule requirement for prior board consent

Under this approach, as found in the FSA Model Code, directors would be obliged to obtain the prior consent of the board before they could lawfully enter into margin loans concerning the shares of the company.

Submissions in favour of this option argued that a uniform approach, obliging all directors of listed entities to disclose to their boards the details of any proposed margin loans and denying them the right to enter into these loans without prior board approval, would better enable boards to assess whether a proposed lending arrangement could:

- materially threaten the company's share price, or
- compromise a director's ability to carry out his or her fiduciary duties

and give boards the opportunity to forestall the transaction in those circumstances.

2.5 Disclosure to the company of margin loans

2.5.1 Current requirement

There is no specific legislative requirement for directors or executive officers to disclose their margin loan arrangements to the company. However, under s 191, directors must disclose to the board any material personal interest they have in a matter that relates to the affairs of the company. The disclosure notice must give details of:

- the nature and extent of the interest, and
- the relation of the interest to the affairs of the company.[40]

ASIC considers that, pursuant to this general provision, directors should disclose all material information concerning a margin loan to their companies:

> Directors have a duty under the Corporations Act to disclose to the company material personal interests on a matter relating to the company. Accordingly, ASIC would expect all directors to have provided the company with all relevant

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40 s 191(3)(a).

> information when a margin loan is entered into over securities in the company.[41]

However, there is a question whether a director's personal arrangements for a margin loan over securities in the company are matters that relate to the affairs of a company.[42] One commentary has argued that:

> The fundamental problem with ASIC's interpretation [of s 191] is that s 191 only mandates disclosure of material personal interests where they relate to the affairs of the company. It will be difficult in most cases to classify margin lending facilities personally held by company directors as relating to the affairs of their companies. Section 191 is concerned with directors' interests in transactions with their company and applies to transactions between the director and the company, whereby the director has profited from transactions within her or his position as director. Based on this application of s 191, it is unlikely that a director would be compelled to disclose personal margin loan arrangements to the board of directors.[43]

2.5.2 United Kingdom

As previously indicated (Section 2.4.2), the FSA takes the view that a director and other person discharging managerial responsibilities (PDMR) must, under the terms of the Model Code, obtain prior clearance from the company before entering into a margin loan, or other arrangement, including a pledge, mortgage or charge, which involves providing securities in the company held by the PDMR as collateral. A company could grant a clearance only if informed of the proposed transaction.

2.5.3 Matters for consideration

The Issues Paper raised a series of policy options concerning the disclosure by directors to the company of margin loan arrangements.

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41 Joint ASIC/ASX Media Release accompanying Companies Update 02/08 (29 February 2008).

42 Blake Dawson *Company Law & Governance Update* 28 March 2008.

43 T Poisel and A Terret, *Transparency and disclosure: Implications of the bear raid on ABC Learning Centres* (2009) 27 C&SLJ 139 at 149–150.

These matters, and a summary of responses in submissions, are set out below.

To some extent, the range of options would be influenced by consideration of matters discussed in Section 2.4. For instance, disclosure would be mandatory if a company had to approve margin lending arrangements in advance.

1 Voluntary approach

Under this approach, it would be a matter for each company to develop a policy on whether directors should disclose margin loan arrangements to the company or what details of those loans should be disclosed, over and above the s 191 disclosure requirements.

For instance, a company could choose to require directors to disclose to the board all relevant information about funding arrangements for all the company's shares held by the director or for a 'material' holding in those shares. That information could include:

- the number of shares covered by a margin loan arrangement
- the circumstances in which a call can be made
- how shares can be sold if a call is not satisfied.

The determination of whether a holding is material could include:

- the size of the parcel of shares subject to the funding arrangement
- whether selling those shares might be expected to affect market trading patterns.

It may also be best practice for details of the company policy regarding internal disclosure of margin loans to be publicly disclosed, say, on the corporate website.

Various respondents supported the approach of leaving it to companies to set the disclosure requirements for directors concerning their margin loan arrangements.

An argument advanced for this flexible approach was that a blanket requirement for directors to disclose to the board details of all margin loan arrangements in all instances could be over-regulatory and serve no good purpose. The mere fact of a director’s margin loan arrangement over shares in the company may often be of limited interest to the market (for example, where the size of the shareholding is insignificant). Rather, the emphasis should be on disclosure of material information (as per ASIC/ASX companies update 02/08).

Some submissions suggested that an internal company policy would facilitate compliance by the board with ASX Listing Rule 3.1, while allowing the board continued flexibility to make decisions about materiality. In formulating a policy, the board should consider:

- the short- and long-term business environments in which the company operates
- the size of potential holdings the subject of any loan.

It was also suggested that any company policy should:

- require 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
- include procedures to ensure adequate supervision and compliance with the policy.

Respondents considered that any company policy should be publicly disclosed on the company’s website and/or in the company’s annual report.

One submission suggested that the company’s policy should indicate when the company must be notified of a margin loan.

2 ASX Corporate Governance Council Principles

The ASX Corporate Governance Council could include additional guidance in its *Principles and Recommendations*. For instance, Recommendation 3.2 could suggest that, as a matter of best practice, a listed company should require that directors or other officers notify it if their shareholdings are supported by a margin loan.

Some submissions favoured this approach.

3 Mandatory disclosure

There could be a specific obligation on directors to disclose to the company when they have entered into a margin loan and to provide all material details concerning the operation of that loan. The UK approach under the Model Code, by requiring prior clearance of entry into margin loan arrangements, in effect requires disclosure to the company of such information as it needs to grant a clearance.

Various respondents favoured mandatory disclosure by directors to the board of all material details of margin loans, as margin lending arrangements:

- could create conflicts of interest for the director, and
- have a direct impact on the company's share price if calls are made and sales take place in consequence.

One approach was for a new disclosure provision, or an amendment to s 191, to place beyond doubt that directors must disclose to the board all material details of margin loans entered into (including the number of shares affected, trigger points for margin calls, and the right of the lender to sell unilaterally), and any changes to those arrangements.

One submission, however, favoured limiting this obligation to where directors held at least 5% of the company's issued securities subject to a margin lending arrangement, arguing that this materiality threshold would provide greater privacy to directors by relieving boards of the need to enquire into directors' personal financial circumstances where the quantity of shares subject to a margin loan or other arrangement is below that threshold.

2.6 Disclosure to the market of margin loans

2.6.1 Current position

Obligations of directors

Section 205G requires directors of a public listed company to notify the exchange of:

- relevant interests in securities of the company, and

- contracts that confer a right to call for or deliver shares in, debentures of, or interests in a managed investment scheme made available by, the company or a related body corporate

within 14 days after their appointment or the listing of the company.[44]

A director must also notify the exchange of any changes in those interests within 14 days.[45] CAMAC has previously recommended that this disclosure period be substantially reduced.[46]

A director is obliged under s 205G to disclose any transactions in securities of the company that he or she holds. This would cover sales pursuant to margin lending arrangements. However, it is less clear whether the directors must also disclose under s 205G when they have entered into margin loans and the details of those loans. A director must disclose contracts to which he or she is a party and 'that confer a right to call for … shares in … the company'.[47] The question is whether this covers entry into margin loans. On one view, information about financing arrangements for a director's shares would not generally be captured by the s 205G and equivalent listing rule disclosure requirements.[48]

The ASX has observed that:

> The Listing Rules and Section 205G, together with the prohibitions on insider trading and market manipulation, help to maintain an informed and orderly market. ASX considers that investors in a listed entity and the market in general, have a legitimate interest in trading by directors. To be useful this information about holdings must be up-to-date and, where changes have occurred, must enable investors to understand the nature of the changes.
>
> ASX recognises that a director may choose to trade an entity's securities for a broad range of reasons which are

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44 CAMAC in its *Insider Trading Report* (2003) recommended that the disclosure period should be reduced from 14 days to 2 business days (except for changes arising under dividend re-investment plans, where the period should remain at 14 days): rec 1.

45 s 205G(4).

46 *Insider Trading Report* (2003), rec 1. See further footnote 44.

47 s 205G(1)(b).

48 Blake Dawson *Company Law & Governance Update* 28 March 2008.

> unrelated to his or her knowledge of the entity and that directors' securities trading is not necessarily an indicator of an entity's prospects. ASX considers that disclosure of directors' transactions is not generally a matter of continuous disclosure, but primarily one of good corporate governance.[49]

Obligations of the company

Supplement to s 205G. The Australian Securities Exchange (ASX) listing rule 3.19A supplements the statutory obligation of directors under s 205G[50] by imposing on listed companies the same type of disclosure obligations as s 205G imposes on directors, though:

- the time limit for disclosure is reduced to 5 business days,[51] and
- the ASX rule goes beyond the language of s 205G by requiring disclosure of details of the value of a transaction and disclosure of the position before and after a transaction.[52]

The obligation to disclose under the ASX Listing Rule falls on the company rather than the director, given the contractual nexus between the exchange and the company under the listing rules. However, ASX Listing Rule 3.19B requires a listed entity to make such arrangements as are necessary with a director of the entity to ensure that the entity can comply with its disclosure obligation under ASX listing rule 3.19A.[53] As stated in an ASX Guidance Note:

> An entity is not required to notify ASX of any information which it does not have, and thus would not be in breach of the Listing Rules in such a case.
>
> If information is not given to ASX because the director has not disclosed it to the entity, the entity does not breach rule 3.19A. However, if the entity does not take action to ensure that the director understands his or her obligations and

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49 ASX, 'Review of directors' trading and trading during the "blackout" period-Q1 2008' (27 June 2008) at 3.

50 The ASX Listing Rules use the concept of 'notifiable interest', which is defined in terms that reflect s 205G: ASX Listing Rule 19.12.

51 See ASX Guidance Note 22 *Director Disclosure of Interests and Transactions in Securities—Obligations of Listed Entities*, para 7.

52 ASX Listing Rules Appendix 3Y, ASX Guidance Note 22, paras 8, 21–22.

53 See also ASX Guidance Note 22, para 9 and Attachment 1.

> makes the required disclosure, the entity will be in breach of rule 3.19B.[54]

Continuous disclosure. ASX Listing Rule 3.1 provides that, once a company becomes aware[55] of information concerning it that a reasonable person would expect to have a material effect on the price or value of the company's securities, the entity must immediately inform the ASX.[56]

The ASX/ASIC joint *Companies Update 02/08* (29 February 2008) sets out their view on how this continuous disclosure listing rule applies to margin lending to directors. It states that, where a director's relevant and material shareholding is subject to a margin loan (or similar funding arrangement), LR 3.1 may, in 'appropriate circumstances', require an entity:

> 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. Whether a margin loan arrangement is material under listing rule 3.1 is a matter which the company must decide having regard to the nature of its operations and the particular circumstances of the company.

The information concerning margin loans that directors may be required to disclose to companies (as discussed in Section 2.5) has a direct effect on what companies have to disclose under the

54 ASX Guidance Note 22, paras 8, 10.

55 An entity becomes aware of information if a director or executive officer has, or ought reasonably to have, come into possession of the information in the course of the performance of their duties as a director or executive officer of the entity (ASX Listing Rule 19.12). A director or executive officer who becomes aware of information must immediately consider whether the information should be made available to ASX: an entity cannot delay giving information to ASX pending formal sign-off or adoption by the board (ASX Guidance Note 8 para 18).

56 An entity must not disclose information that is for release to the market to anyone (including the media, even if the information is embargoed) until it has given the information to ASX and has received an acknowledgement from ASX that the information has been released to the market: ASX Listing Rule 15.7, ASX Guidance Note 8 para 22, Guidance Note 14 *Company Announcement Platform*. Making the Company Announcement Platform the central collection point for market-sensitive information is designed to ensure the efficiency and integrity of the process of release of market information and significantly reduce the risk of insider trading and unequal access to information (ASX Guidance Note 8 para 23). A further useful summary of the continuous disclosure rules and legislation is set out in T Poisel and A Terret *Transparency and disclosure: Implications of the bear raid on ABC Learning Centres* (2009) 27 C&SLJ 139 at 144–149.

continuous disclosure requirements. A company would only be in a position to disclose details of the loan arrangements to the extent that the director has provided it with this information.

One commentary[57] has expressed the following view on the effect of LR 3.1 on margin loans:

- a decision on whether a director's margin loan arrangement will have a material effect on the price or value of an entity's securities could involve an assessment of the size of the director's shareholding as a portion of the total register—the larger the director's shareholding, the more material any margin loan arrangements may be

- it is arguable that there is no need to disclose those arrangements where the director's shareholding represents a very small portion of the entity's total issued share capital.

Another commentator[58] has said, for the purpose of the listing rule:

> In deciding the 'materiality' of a director's margined interest, factors such as liquidity, company size and levels of short selling may be taken into account.

A judgment of materiality may fluctuate frequently in volatile trading conditions.[59]

Preventing a false market. ASX Listing Rule 3.1B requires a listed entity, on request, to give ASX information needed to correct or prevent a false market in the entity's securities.

The ASX/ASIC joint Companies Update 02/08 Companies Update 02/08 states:

> Listing rule 3.1B applies where ASX considers that there is or is likely to be a false market, and in such circumstances an entity must disclose information necessary to correct or prevent a false market. This requirement may arise even

57 Blake Dawson *Company Law & Governance Update* 28 March 2008.

58 Cooper Grace Ward Lawyers 29 April 2008 'Risky business: limiting director exposure to margin borrowing'.

59 Australian Institute of Company Directors, *Position Paper No. 9—Directors' Margin Loans* (2008).

> though the entity is not aware of any information that would be required to be disclosed under listing rule 3.1.

Obligations of the lender

Whether, or in what circumstances, a lender will have to make disclosures to the market upon entry into a margin loan contract depends upon the terms of the security arrangements under the contract.

In most cases, the lender would take an equitable mortgage or charge over the securities, falling short of a relevant interest in them.[60] A lender who acquired a relevant interest in shares, initially or subsequently, would be subject to disclosure if the total relevant interest of the lender in the shares of the company reached the 5% substantial shareholding threshold.[61]

2.6.2 Other jurisdictions

United Kingdom

As earlier indicated (Section 2.4.2), a PDMR (person discharging managerial responsibilities) must obtain clearance from the company before any dealing in the securities of the company, including entry into a margin loan or other financing transaction involving those securities.

The relevant disclosure obligations for transactions that have been cleared in advance by the company are found in Chapter 3 of the FSA Disclosure and Transparency Rules (DTR 3.1). This chapter sets out the notification obligations of issuers [listed companies] and PDMRs in respect of transactions conducted by PDMRs, or by connected persons on their account, in shares of the issuer, or derivatives or any other financial instrument relating to those shares. The DTR requirements are based on the 2003 EU *Market Abuse Directive*.[62]

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60 See definition of 'relevant interest' in s 9 and ss 608(1) and 609(1).

61 See definition of 'substantial holding' in s 9 and s 671B.

62 DTR 3.1 is based on Article 6(4) of the European Union *Market Abuse Directive* (Directive 2003/6/EC) and Article 6(1) of Directive 2004/72/EC.

Disclosure by a PDMR to the market

The DTR require the notification of 'transactions' by PDMRs. A question remains whether the term 'transaction' is as wide as the concept of 'dealings' used in the Model Code, and therefore whether the DTR requirements extend to the disclosure of margin loan arrangements.

The FSA has stated that grants of security over shares by PDMRs (by the creation of a security interest such as a pledge, mortgage or charge) are covered by the disclosure requirements of DTR 3.1.[63] In consequence:

> those PDMRs who have granted security over their shares should disclose this to the market as soon as possible.[64]

There has been some questioning of this view in the market, based on a claimed narrower meaning of the word 'transaction' in the EU *Market Abuse Directive*.

To the extent that disclosure is required, as the FSA has contended, there does not appear to be any requirement of particularity in relation to the level of detail disclosed. It is not clear that disclosure to the market would extend beyond an indication of the number of a PDMR's shares that are subject to a pledge or like financial instrument or the percentage of the PDMR's total shareholding that the shares represent. While further detail may not be required, it would be in the discretion of a PDMR to disclose further details to the market with a view to providing context.

Disclosure by the company to the market

PDMRs are required under DTR 3.1.2 to:

> notify the issuer in writing of the occurrence of all transactions conducted on their own account in the shares of the issuer, or derivatives or any other financial instruments

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63 FSA, *Disclosure and Model Code obligations in respect of the use of shareholdings as security* (9 January 2009), FSA/PN/005/2009. This statement by the FSA was, in part, an aftermath of developments concerning the Deputy Chairman of Carphone Wharehouse in the UK, who was forced to resign after failing to disclose that he had used shares in the company to secure personal loans.

64 ibid.

> relating to those shares within four business days of the day on which the transaction occurred.[65]

A company that has been informed by a PDMR of such a transaction must disclose this information to the market as soon as possible, and in any event by no later than the end of the business day following the receipt of the information.[66]

In relation to the information that a company must disclose to the market, the issues about the meaning of 'transaction' that arise for PDMRs also apply to the company.

European Union

Different policies have been adopted among other EU States on these market disclosure matters. Moves are under way to reach a common approach.[67]

USA

Listed companies must publicly disclose, at least annually, the total number of their securities that are beneficially owned by directors and executive officers, individually and as a group, and provided as collateral.[68] They must also, at least quarterly, describe any arrangements known to them involving 'any pledge by any person of

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65 Disclosure and Transparency Rules (DTR) 3.1.2, DTR 3.1.3 set out the information to be included in the notice.

66 DTR 3.1.4, DTR 3.1.5, DTR 3.1.6. The information to be disclosed is that supplied by the PDMR to the company under DTR 3.1.3. The form for the disclosure by the company is referred to in DTR 3.1.7.

67 The UK disclosure requirements in DTR 3.1 are designed to implement Article 6(4) of the *Market Abuse Directive* (Directive 2003/6/EC), which states that 'Member States shall ensure that public access to information concerning such transactions, on at least an individual basis, is readily available as soon as possible'.
However, as pointed out by the Financial Regulator (Ireland) in *Disclosure of Grants of Security over Shares* (Consultation Paper 2009) at 4:

> the EU *Market Abuse Directive* (2003/6/EC) does not define specifically which transactions fall within its disclosure requirements. As a result, different approaches have emerged in different European markets in respect of the disclosure of granting of security over shares. The European Commission and the Committee of European Securities Regulators are endeavouring to reach a common understanding on the detail of the Directive requirements in this area.

The Financial Regulator (Ireland) considers that, in principle, grants of security over shares should be disclosed in the interests of enhanced market integrity: id at 5.

68 Form S-K Item 403(b), Form 10-K, Item 12.

securities of the registrant or any of its parents, the operation of which may at a subsequent date result in a change in control' of the company.[69]

Canada

There is specific regulation concerning 'equity monetization' transactions by directors and other corporate officers. These transactions permit persons to convert the securities they hold in the company into a cash amount comparable to what they would have received on a disposition of such securities. As a result of transactions of this kind, a director or other officer is able to transfer all or part of the economic risk associated with the securities without actually transferring ownership of the securities and without incurring potentially significant taxable capital gains.

Directors or other officers entering into equity monetization transactions must publicly disclose the existence and material terms of any agreement, arrangement or understanding, which may include a margin loan or other pledge arrangement, that alters their 'economic interest in a security' of the reporting issuer, or alters their 'economic exposure' to the reporting issuer.[70] However, this disclosure requirement does not apply to:

> … (e) a transfer, pledge or encumbrance of securities by an insider for the purpose of giving collateral for a debt made in good faith so long as there is no limitation on the recourse available against the insider for any amount payable under such debt; or
>
> (f) the receipt by an insider of a transfer, pledge or encumbrance of securities of an issuer if the securities are transferred, pledged or encumbered as collateral for a debt under a written agreement and in the ordinary course of business of the insider …[71]

In consequence, the details of limited recourse margin lending arrangements must be publicly disclosed where the recovery rights of the lender are confined to the securities in the company held by

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69 Form S-K Item 403(c), Form 8-K Item 5.01(b) read together with Form 10-Q Item 5.

70 Multilateral Instrument (MI) 55-103—Insider Reporting for Certain Derivative Transactions (Equity Monetization).

71 s 2.2 of MI 55-103.

the borrower, in effect transferring any financial risk associated with a decline in the value of the securities to the lender.

By contrast, details of unlimited recourse margin lending arrangements need not be publicly disclosed, that is, where the borrower remains personally liable for the margin loan, with the lender having rights to move against all the assets of the borrower in the event of default.

Hong Kong

There is a general obligation on directors and chief executives of a listed company to disclose to the Stock Exchange, as well as to the company, within 3 business days, all their interests in shares or other securities of the company, and changes to those interests, other than interests to be disregarded.[72] Substantial shareholders have the same obligation.[73]

There is also a listing rule requirement that a company disclose any pledging by a director of the director's shareholding in support of borrowings by the company.[74] One reason for this requirement is the relatively high proportion of companies in that jurisdiction that are, in effect, controlled by various family shareholdings.

For the purpose of these public disclosure obligations, disregarded interests include an interest in shares held by a 'qualified lender'[75] by way of security for a transaction entered into in the ordinary course of the business of that lender.[76] In consequence, while directors and other senior corporate officers must disclose their full shareholding in the company, there is no general obligation also to disclose margin loan arrangements concerning any of those shares that have been entered into with a qualified lender.

72 Hong Kong Securities and Futures Ordinance Part 15: Disclosure of interests.

73 ibid.

74 Listing Rules (Main Board) 13.17, 13.18.

75 Hong Kong Securities and Futures Ordinance Part 15: Disclosure of interests, s 308 definition of 'qualified lender', which includes an authorised financial institution, an authorised insurance company, an exchange participant of a recognised exchange company and an intermediary licensed to deal in securities or margin financing.

76 ibid ss 323(1)(f), 323(6).

An interest in shares of the company ceases to be a disregarded interest, and the lender shall be taken to have acquired that interest if, in consequence of a default, the lender becomes entitled, and intends, to exercise the voting rights attached to the shares or if the lender, under a power of sale that has become operable, seeks to sell the shares.[77]

2.6.3 Matters for consideration

The Issues Paper raised a series of questions and policy options concerning the disclosure by directors, or the company, to the market of margin loan arrangements.

These matters, and a summary of responses in submissions, are set out below.

1 Whether there should be additional market disclosure requirements for directors

Arguments for additional market disclosure requirements on directors for their margin loan arrangements include:

- *clarity for disclosing parties:* the application of the current disclosure requirements to margin loans is not clear. Introducing a specific market disclosure requirement for margin loans would add to certainty and levels of compliance

- *information to the market:* arrangements that give third parties rights over the shareholdings of directors can have very material impacts on the market price of a company's shares. For instance, there may be a significant adverse impact on the market price of a company's shares where a director is required to divest large parcels of shares as a result of a margin call. Better disclosure to the market would improve the ability of market participants to assess the risk of divestiture of material shareholdings by directors.

Arguments against additional market disclosure requirements on directors directed specifically at their margin loans include:

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77 ibid s 323(7).

- directors may be discouraged from acquiring a significant parcel of the company's shares if the regulation of margin loan arrangements is considered too onerous

- the risk to the market from margin loans is questionable where a director's shareholding is insignificant relative to the company's overall issued capital.

A related issue in introducing any further market disclosure requirements on directors is whether they should apply in all instances or only where the affected shares constitute a material proportion of the company's share capital. One possibility is to limit the disclosure requirement to those directors who are also substantial shareholders,[78] given that a substantial shareholding may be sufficiently large that its sale in response to a margin call could materially affect the market price of the company's shares.

There was support in some submissions for the principle that directors be obliged to disclose to the market material details of their margin lending arrangements. Some respondents considered that a disclosure obligation of this nature could best be achieved by amending s 205G, to place beyond doubt that the obligation on the director to disclose to the market includes margin loans entered into by that person. Some of those respondents also favoured reducing the time limit for disclosure under this provision to align with the counterpart disclosure requirement under ASX Listing Rule 3.19A.

Another approach in submissions was that it should be left to each company to determine, as part of its code of conduct for directors, whether information concerning margin loans directors should be disclosed to the market.

2 What information directors should disclose to the market

There was a range of views in submissions on what initial and ongoing information should be disclosed to the market by the director. Suggestions included:

- all the material terms of the initial margin loan arrangements and the number of shares subject to the margin loan, and any

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[78] Part 6C.1, definition of 'substantial holding' in s 9.

material amendments to those arrangements, possibly excluding (i) the initial amount advanced (as short sellers could deduce the price triggers for margin calls if they knew the loan to valuation for the security) and (ii) the price triggers at which margin calls can be made (as this detail may encourage some market participants to sell shares in the company for the purpose of triggering margin calls)

- the occurrence of an event that triggers a potential obligation to transfer shares to a third party, for instance a financier making a margin call
- a decision by the director or officer affecting whether the shares will be transferred to a third party, for instance, the decision to provide funds to meet a margin call rather than allow the financier to sell securities covered by the margin lending facility
- where a director receives notification that a lender has exercised or intends to exercise its right to sell shares
- the fact that shares have ceased to be subject to the margin loan, whether due to (third party or personal) disposal of the shares, paying out the loan, or otherwise.

3 Whether there should be additional market disclosure obligations for companies

It was noted in the Issues Paper, and in submissions, that the nature of any market disclosure obligation on directors (refer above) would be one factor in determining what information, if any, concerning margin loans a company, in principle, should have to disclose to the market. Also, any disclosure obligation on companies would only be effective to the extent that directors were under an obligation to disclose all relevant information to the company.

Various approaches were proposed in submissions.

(a) Corporate discretion subject to existing Listing Rules

Corporate disclosure to the market concerning margin loans should remain a matter for the board, subject to compliance with the continuous disclosure provisions. On this basis, margin loan arrangements need only be disclosed if, and to the extent, required in the circumstances under ASX Listing Rule 3.1.

An argument put forward for this approach is that ASX Listing Rule 3.1 better allows appropriate account to be taken of various factors in determining what, if anything, should be disclosed about a margin loan, such as the size of the loan, the loan to share valuation ratio, the market capitalisation of the company, the number of shares to which it relates and the liquidity of the company's securities.

Another respondent said that ASX Guidance Note 8 on continuous disclosure could be updated to include specific guidelines on directors' margin loans.

(b) Amend the Listing Rules

One submission suggested that the requirement for the company to disclose to the market under ASX Listing Rule 3.19A could be clarified to ensure that 'notifiable interests' includes all margin loans to directors.

Another submission said that, to enable investors to know if control of the sale instructions is exercised by the lender and not the director, Appendices 3X, 3Y and 3Z of the ASX Listing Rules (which implement ASX Listing Rule 3.19A) could be amended to show:

- that the notifiable interest of a director was the subject of a mortgage or margin loan
- details of when the board approved the arrangements.

Another approach in submissions favoured the ASX:

- amending its Listing Rules to require companies to notify the market when a director holds sufficient shares in the company subject to third party rights that their sale in response to a margin call could materially affect the market price of the company's shares, and
- issuing a guidance note detailing what information is being sought and for what purpose.

(c) Statutory obligation

One approach suggested in submissions was that companies be obliged to disclose to the market margin loan arrangements relating to 'non-trivial parcels of shares', say, between 0.25% and 1% of the company's shareholding.

The initial and ongoing information to be disclosed by the company (as supplied to it by the director) could be of the same nature as discussed above in submissions concerning disclosure by directors to the market.

2.7 A more generic approach to disclosure

2.7.1 Matters for consideration

The Issues Paper raised the question of developing a more generic principle-based provision for disclosure by directors to the company, and to the market, of all their interests in the securities of the company, including interests derived through transactions in the securities of the company, or derivatives over these securities, or margin lending or other financing arrangements involving the securities of the company (economic interests).

2.7.2 Disclosure by directors to the company

One view in submissions was that disclosure of a broader range of interests by the director to the company should remain a matter of company policy rather than legislative prescription.

A differing view was that any mandatory disclosure by directors to the company of margin loan arrangements (by amendment to s 191 or through a new provision) should extend also to the disclosure of transactions affecting 'economic interests'. This would include transactions affecting securities that are hedged into the quoted securities market (for instance, contracts for difference, options and other derivatives, of whatever amount).

2.7.3 Disclosure by directors to the market

One submission proposed that the disclosure obligations of directors under s 205G be expanded:

- to extend to any agreement, arrangement or understanding with a third party under which a director's economic interest in the securities of the company would be affected. This would avoid an impression in the market that a director's interest is fully aligned with those of other security holders when the director has sold the economic interest in his or her securities

- to require disclosure of any third party's relevant interests in the director's securities, including those that would be disregarded under ss 609(1) (financial accommodation), 609(6) (market-traded options and derivatives) and 609(7) (conditional agreements). The details to be disclosed should be:
  - the identity of the third party with the relevant interest
  - the nature of the relevant interest
  - a short description of the agreements under which it arose
- by extending the requirement in s 205G(1)(b) to disclose contracts to which the director is a party, or under which the director is entitled to benefit, and which confer a right to call for or deliver securities, so that it applies to entities under the director's control. This would catch margin loans structured as securities lending arrangements where the director holds the securities through his or her family company or family trust. Those arrangements would not necessarily be caught under the second dot point, as financiers do not necessarily have a relevant interest in securities that they have on-lent.

2.7.4 Disclosure by companies to the market

A number of submissions argued that the continuous disclosure requirements suffice, and did not support any further generic disclosure requirement being placed upon companies.

2.8 Additional matters

2.8.1 Insider trading

Transactions in securities in consequence of a margin call are subject to the exemption in Corporations Regulations reg 9.12.01(e) from the insider trading provisions for the 'sale of financial products under a mortgage or charge of the financial products'. This exemption would cover sales of securities by lenders, and possibly by borrowers, in consequence of margin calls on those securities.

ASIC proposed in its submission that this exemption be removed, as:

- a director or senior executive could benefit by acquiescing in a margin call to have shares sold where that person is aware of inside information that will reduce the market price of those shares

- lenders commonly have price-sensitive information in moments of financial stress and should not be able to sell securities to a person who is not aware of that information.

Concerns were expressed in some submissions about the possible impact on margin lending arrangements of removing the exemption in reg 9.12.01(e), particularly if it inhibited the ability to sell securities following the making of a margin call, because of inside information held at that time by either the borrower or the lender. One suggestion was that there be a specific defence to a charge of insider trading against a borrower who has inside information where the lender, who does not have this information, exercises the right to sell the securities following failure by the borrower to meet a margin call.[79]

2.8.2 Substantial shareholding

ASIC proposed that consideration be given to removing the exemption from the substantial holding disclosure requirements for lenders whose interest in securities arises solely because of a mortgage, charge or security taken by them in the ordinary course of their business[80] where a lender has an absolute power to sell securities on the occurrence of a market event, as is the case with margin lenders.

2.9 Advisory Committee position

Shareholdings by directors

The holding by directors or executive officers of shares in their company is generally regarded as a good thing in aligning their interests with those of other shareholders. This is not to say that

79 This would also overcome the problem of determining whether a borrower, by failing to meet a margin call, ‘procured’ the lender to sell the shares. Procuring is defined in s 1042F.

80 s 609(1).

share ownership by directors or executive officers should be seen as essential or as an absolute value to be pursued in all circumstances and whatever the cost.

It is interesting to note that the earlier practice by which companies required directors to hold a specified number of shares by way of qualification under their constitution has largely fallen away. The statutory requirement for directors to have a shareholding qualification was repealed in 1998. While share ownership by directors may generally be beneficial, an argument can be made that the holding of shares by non-executive directors could serve in some circumstances to fetter their independence, for instance, their ability to walk away from the company on a matter of principle.

Generally speaking, any requirement or recommendation for the holding of shares by directors or executive officers should be left to company policy, and beyond that to the judgment of the person in question.

Funding of director shareholdings

The manner in which directors and executive officers fund their purchase of shares should, as with any other investor, be a matter for their own judgment in the first instance, having regard to their means and financial circumstances. There is no warrant for an outright prohibition on margin loans (or any borrowing arrangements) by these persons. An effective prohibition of that kind would in any event be difficult to frame, given the scope for circumvention through the use of other forms of financial accommodation.

A director or executive officer is not, however, in the same position as any other shareholder in deciding when to purchase shares in the company and how to fund that purchase. A director or executive officer needs to keep in mind his or her fiduciary duties to the company and should eschew any borrowing arrangement that could give rise to a conflict of interest (such as between a decision in the interests of the company and short-term pressures arising from the company's share price under a loan arrangement). A director or executive officer who purchases securities in the company pursuant to a borrowing arrangement that turns out to be unsustainable may come under pressure to dispose of those shares at a time of weakness in the market price, thereby adding to downward pressure on the price.

Again, by virtue of their privileged position, directors and executive officers are, and should be, constrained in their ability to deal in the shares of the company at particular times. They risk putting themselves in an untenable position under the insider trading laws if they take on obligations under a borrowing arrangement that could result in a need to sell shares at a time not of their choosing.

Corporate interest in director share dealings

As a matter of good governance, a company should take an interest in all dealings in its securities by its directors and executive officers, whether in shares or other economic interests, and however funded, given the position of control or influence they occupy within the company.

The Advisory Committee considers that margin lending on the part of directors and executive officers should be considered as part of the wider issue of the regulation of dealings by those persons in the securities of their company. All these dealings should be covered, not just those that would be subject to disclosure under the substantial shareholding requirements.

The UK Model Code is an example of best practice in relation to the regulation of dealings by directors and executive officers in the securities of their company.

Clearance to deal

As a matter of best practice, a well-run company should, in its own interests and in the interests of its officers, have a policy requiring directors and executive officers:

- to inform the company in advance of any proposed dealing by them in the securities of the company. Dealings, for this purpose, include the acquisition or disposal of the company's shares, transactions in derivatives over the company's securities, or entry into any financial arrangement by which, through a pledge, mortgage, lien, charge or other encumbrance, the securities of the company are used as collateral for any purpose, including to fund the purchase of the securities

- to obtain clearance from the board, or a person designated by the board, before entering into the dealing

- to undertake any approved dealing no later than two business days after receiving clearance.

This is the approach adopted in the UK Model Code.

Certain passive and other dealings, where prior approval is not warranted, should be exempt from this requirement. This exemption would include transactions pursuant to a rights issue, a dividend reinvestment or an employee share scheme, acceptance under a takeover offer or other change of control scheme, or where there is no change in the beneficial interest in the securities.[81]

A clearance requirement provides a board, or the person designated by the board, with the opportunity to consider whether a particular dealing by a director or executive officer in the company's securities may, for instance:

- create a problem or perception of trading with an informational advantage, which may result in insider trading or undermine market confidence in the company's securities
- create a potential conflict between the director or executive officer's own interests and the duties of that person to act in the best interests of the company
- pose risks of a possible forced sale of the company's securities
- create a misleading impression of the nature of the director's or executive officer's economic interest.

Subject to certain constraints (refer to Section 3.6 on trading during a blackout period), it would be a matter for a company to develop its own policy for clearance of dealings within this framework, as under the UK Model Code.

As part of this clearance process, a company should maintain a record of all dealing approvals given. Appropriate record-keeping adds an internal check and discipline on the granting of clearances to deal and assists in any later review of decision-making.

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81 See the UK Model Code para 2: **Dealings not subject to the provisions of this code.**

In the Advisory Committee's view, the implementation of a clearance process should be approached as a matter of promoting best practice in this area of governance.

One way for this to be implemented would be to introduce in the ASX Corporate Governance Council *Principles and Recommendations* a requirement that each listed company, as a minimum standard, adopt these clearance and recording principles for all dealings by directors or executive officers in its securities, or explain why not (the 'if not, why not' reporting requirement).[82] These requirements would need to be prescriptive, clear and self-contained, along the lines of the UK Model Code, and could also indicate that companies could go further and have more stringent requirements if they wished.

While the 'if not, why not' approach is suitable for many recommendations in the area of governance best practice, there is a question whether it is sufficient in more critical areas. While responsible companies are likely to follow or go further than recommended practice, other companies where the need for rigour may not be understood may be less likely to do so.

It would be open to the ASX to consider whether it would be more appropriate to treat these recommended clearance processes for share dealings by directors and their executive officers as core governance requirements that should be made mandatory for all listed companies through the listing requirements. This approach would be more akin to the position in the United Kingdom.

In the absence of effective implementation in a governance context, a legislative approach could be considered. While not recommended at this stage, a possible legislative model for enforcing clearance and recording requirements would be Chapter 2E of the Corporations Act (related party transactions). That chapter imposes personal liability on individuals, while protecting counterparties and the interests of the company.[83]

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82 ASX Listing Rule 4.10.3.
83 s 209.

Market disclosure of approved dealings

The market has a legitimate interest in being informed of dealings by directors and executive officers in the securities of their company. Any transaction that would require prior clearance by a company under the Advisory Committee's recommendations should be disclosed to the market after the event.

Disclosure by directors and executive officers

Directors are already obliged under s 205G to disclose certain information to the market regarding their dealings in the securities of their company. This disclosure obligation should be extended to executive officers as well as directors.

Also, in principle, the Advisory Committee would support extending s 205G to cover all dealings in securities (as that term is used in this report), thereby covering all economic interests in securities. It is noted that a Treasury paper has also raised issues concerning the application of s 205G to economic interests through derivatives.[84]

A notice under s 205G should give an indication of the type of dealing that has taken place. However, it is not proposed to require disclosure of details of a particular financial arrangement, which other market participants could use to their advantage. It would always be open to the person in question to provide more information.

The time limit for disclosure under s 205G should be no longer than 5 days, in line with ASX LR 3.19A.[85]

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84 In June 2009, Treasury published an issues paper *Improving Australia's Framework for Disclosure of Equity Derivative Products*. In the context of its general review of the disclosure of equity derivatives, the paper pointed out that, while s 205G requires directors of listed companies and managed investment schemes to disclose their relevant interests in the entities they manage, this provision does not extend to equity derivative positions referenced to the company's shares. In consequence:

> directors could acquire or dispose of their interests through the use of equity derivatives and not be required to disclose these dealings (para 12).

The paper raised the general question whether the current disclosure regime (including disclosure by directors) should be amended to include the transfer of economic interests, control and voting rights through derivative contracts.

85 The CAMAC *Insider Trading Report* (2003), rec 1, recommended that the 14 day disclosure period be reduced to 2 business days.

Disclosure by the company

At present, a company is required to disclose in its annual report the holdings of securities in the company by its directors.[86] This requirement should be extended to include a reference to the number or percentage of its securities held by directors or executive officers, individually and collectively, that are, or at any time in the previous financial year have been, subject to a pledge or other financial arrangement. It would be open for a company or a director or executive officer to provide further explanation of these arrangements in any case where that seemed appropriate.

Apart from this, any further disclosure that a company is obliged to make should arise only under the continuous disclosure requirements. In exceptional cases, where the circumstances relating to the holding of a director or executive officer could have a material effect on the price or value of the company's securities, the company may need to make some disclosure to the market about those matters.

Application of the insider trading provisions

The Committee sees no reason why a forced sale of securities under financial arrangements freely entered into by a director or executive officer with a lender should be exempt from the insider trading laws.

The Committee therefore supports repeal of Corporations Regulations reg 9.12.01(e), which exempts from the insider trading provisions sales of securities by lenders, and possibly borrowers, under a charge or other encumbrance. Likewise, s 609(1) should be amended to remove the substantial shareholding notification exemption for lenders. Borrowers and lenders should not be in a privileged position compared with other market participants. They can take the implications of the insider trading laws into account when considering whether to enter into margin lending or other arrangements involving the company's securities. Also, it is open to lenders to employ Chinese walls to ensure that they do not breach the insider trading provisions if they undertake transactions pursuant to the terms of their loan agreements.

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86 s 300(11).

In considering the application of the insider trading laws, the Committee supports the view taken by the SEC that, for the purposes of the insider trading provisions, transactions in the securities of the company entered into in consequence of a margin call should, in general, still be considered transactions entered into by the borrower (even if the lender is the transacting party), as these types of transactions generally remain within the borrower's discretion.[87] It may be beneficial to clarify the insider trading laws in this respect, to overcome any uncertainty about whether a borrower could be said to have 'procured' transactions by the lender in these circumstances.[88]

Non-discretionary trading plans

The Committee also recognises that it can be difficult for responsible directors, executive officers and other corporate insiders to transact in the securities of a company for legitimate purposes, given that there may be long periods during which they are exposed to inside information. The Committee reiterates the recommendation in its *Insider Trading Report* (2003)[89] that dealings under non-discretionary trading plans be permitted as an exception to the insider trading provisions, as in other jurisdictions.[90] This will allow a corporate insider to adjust his or her portfolio in the securities of the company through transactions entered into on that person's behalf from time to time in order to meet regular or anticipated financial commitments or objectives, without the transactions being impeded by the possibility that the insider may hold inside information when such transactions are effected.

While the Committee does not see a need for clearance of these plans, or transactions under them, it notes other controls to avoid possible abuse of them (see further Section 3.6).

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87 See further Section 2.4.2.

88 A person with inside information is prohibited from 'procuring' another to transact in affected securities: s 1043A(1)(d). Procuring is defined in s 1042F.

89 CAMAC *Insider Trading Report* (2003) Section 2.6 and rec 16.

90 In the UK, there is an express exemption from the blackout trading period for non-discretionary trading plans. Trading under non-discretionary trading plans is recognised in US and Canadian law as an exemption from their insider trading prohibitions. Further details of the requirements for these plans are set out in Section 3.4.2 [USA] and Section 3.4.3 [Canada].

3 'Blackout' trading

This chapter considers trading by directors and executive officers in the securities of their company in price-sensitive periods, such as between the close of a company's books and the release of annual or periodic financial results, and its consequences for investor confidence in the integrity of the financial market. It outlines current regulatory requirements, including the prohibitions on insider trading and disclosure obligations, as well as ASX surveys of market practice. It reviews law and practice in other countries. It recommends steps to bring about best practice governance processes to regulate trading by directors and executive officers in market-sensitive periods.

3.1 The Minister's request

The Minister's letter expressed concern that active trading by directors in price-sensitive periods such as between the close of a company's books and the release of results has the potential to affect confidence in the integrity of Australia's markets. The Minister's media release accompanying the reference stated that:

> Research has found a very significant lack of compliance with regard to rules around trading in the 'blackout' period. This is unacceptable and makes a mockery of the rules restricting such trading.

The Minister has asked CAMAC to:

- examine how overseas jurisdictions regulate 'blackout' trading, and compare and contrast overseas regulation with that of Australia
- given the already extensive insider trading prohibition, advise whether changes are required to Australia's regulatory framework to provide for greater confidence in the integrity of the market, specifically relating to directors' trading activity
- advise what form any such changes should take if they are required.

3.2 Background

Against the background of the prohibition on insider trading, some companies have adopted a policy by which directors or other officers are precluded from transacting in the company's securities during all or part of certain periods, including the period between the close of a financial reporting period and the release by the company of the results for that period (the blackout period). Some companies use the alternative terminology of 'trading windows', that is, prohibiting trading by corporate insiders in the securities of the company at any time except during various windows periods, typically after release of financial results.

Companies are encouraged under the ASX Corporate Governance Council guidelines to adopt a blackout trading policy, having regard to the sensitivity of any trading by directors or other officers prior to the announcement of a company's results (see below).

Also, as observed by the ASX:

> A trading policy which includes a provision for a blackout on trading by directors and others in the period between the close of books and the announcement of full or half-year results acts as a mechanism for minimising the potential for any perception that directors or others are dealing in the entity's securities while in possession of inside information. Trading policies frequently permit trading in 'windows' following the full and half year results' announcements.[91]

There is no statutory definition of a blackout period, nor is there a prohibition on such trading. Rather, it is a matter for each company to decide:

- whether to have a blackout trading policy in relation to all or some of its own securities
- to whom within the company that policy will apply
- during what period the blackout will operate, and

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91 ASX, 'Review of directors' trading and trading during the "blackout" period-Q3 2008' (11 December 2008) at 4.

- whether any exemption from blackout trading can be granted, by whom and on what basis.

It is common for a company policy on blackout trading to provide that a designated person, such as the chair of the board of directors, may authorise transactions that would otherwise be contrary to that policy.

3.3 Current position

3.3.1 Regulatory requirements

While blackout trading is not in itself prohibited, transactions in securities of a company by its directors or other insiders within a blackout period may contravene the law in certain circumstances. The prohibitions on insider trading, improper use of corporate position or information and market misconduct are relevant. These prohibitions are:

- the insider trading provisions, which prohibit anyone with confidential price-sensitive information from transacting in affected securities, procuring any other person to transact in those securities or passing on the information to any person who is likely to transact (Part 7.10 Division 3 of the Corporations Act)[92]
- s 182, which prohibits directors or other officers from improperly using their position in the company to gain a personal advantage
- s 183, which prohibits directors or other officers from improperly using company information to gain a personal advantage
- the prohibitions on market manipulation and other forms of market misconduct in Part 7.10 of the Corporations Act.

92 The insider trading provisions are analysed in detail in the CAMAC publications *Insider Trading Discussion Paper* (2001), *Insider Trading Proposals Paper* (2002) and *Insider Trading Report* (2003), available at **www.camac.gov.au**

There are also disclosure requirements in relation to directors' trading, including during blackout periods:

- s 205G, which requires a director of a listed public company to notify the ASX of any changes in the relevant interests he or she holds in the securities of the company, or any related company.[93] CAMAC has recommended various amendments to this provision, including that the period for disclosing information be substantially reduced[94]
- ASX Listing Rule 3.19A (complementing s 205G), which requires ASX-listed entities to notify the ASX of 'notifiable interests' of directors when the entity is admitted to the official list and when the director is appointed and also to notify the ASX of changes in notifiable interests, and Listing Rule 3.19B, which requires listed entities to make arrangements with their directors to ensure that the directors disclose to the entities all information necessary to comply with the disclosure obligation.

3.3.2 Corporate governance principles

The ASX Corporate Governance Council *Principles and Recommendations* Recommendation 3.2 states 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.

The commentary on this recommendation states that:

> public confidence in the company can be eroded if there is insufficient understanding about the company's policies governing trading by 'potential insiders'.

The commentary states that:

> where companies establish a trading policy, they should also introduce appropriate compliance standards and procedures to ensure that the policy is properly implemented. There

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93 See further ASIC Regulatory Guide 193, 'Notification of directors' interests in securities—listed companies' (June 2008).

94 CAMAC, *Insider Trading Report* (2003) rec 1. See further footnote 44.

> should also be an internal review mechanism to assess compliance and effectiveness. This review may involve an internal audit function.

Within that context, the commentary, in Box 3.2, puts forward various matters that companies may find useful when formulating a trading policy, including to:

- identify clearly the directors, officers, employees or group of employees who are restricted from trading ('designated officers')
- identify whether trading windows or blackouts are used and, if so, details of their application
- specify whether there is any discretion to permit trading by designated officers in specific circumstances (for example, financial hardship), details of such circumstances, and the basis upon which discretion is applied
- make clear that it is inappropriate for the designated officer to procure others to trade when the designated officer is precluded from trading.

The commentary also makes suggestions about extending a blackout trading policy to various linked financial products.

The corporate governance principles and recommendations elsewhere state that the exercise of any entitlements under equity-based remuneration schemes should be timed to coincide with periods when trading is permitted under any trading policy established by the company.[95]

A company is required to provide a statement in its annual report disclosing the extent to which it has followed the *Corporate Governance Principles and Recommendations*.[96] Recommendation 3.3 is that companies should provide in their annual reports the information set out in the 'Guide to reporting on Principle 3', including an explanation of any departure from

95 Item 3 (equity-based remuneration) of box 8.1 (Guidelines for executive remuneration packages) of recommendation 8.2.

96 ASX Listing Rule 4.10.3.

Recommendation 3.2. Also, the following material should be made publicly available, ideally by posting it on the company's website in a clearly marked corporate governance section:

- any applicable code of conduct or a summary
- the trading policy or a summary.

3.3.3 Survey results

The ASX has issued three reports covering directors' trading in the securities of their companies during blackout periods in the first quarter and third quarter of 2008 [Q1, 2008 and Q3, 2008] and the first quarter of 2009 [Q1, 2009].[97] This is part of an ongoing ASX survey process.[98]

For the purposes of these reports, the ASX defines a blackout period as the period between the close of a company's books and release of half-year or full-year results.

The ASX reports indicate that:

- 42% [Q1, 2008] 50% [Q3, 2008] and 33% [Q1, 2009] of active trading by directors in the securities of their companies took place during a blackout period, as defined by the ASX. The ASX uses the term 'active' trading to cover on-market trading, and excludes 'passive' changes of relevant interests, such as through employee incentive schemes, dividend reinvestment schemes, share purchase plans and rights issues
- 92% [Q3, 2008] and 86% [Q1, 2009] of the companies surveyed had trading policies

97 ASX, 'Review of directors' trading during the "blackout" period-Q1 2008' (June 2008); ASX, 'Review of directors' trading during the "blackout" period-Q3 2008' (December 2008), ASX, 'Review of directors' trading during the "blackout" period-Q1 2009' (June 2009).

98 The ASX announced in June 2008 that it will carry out reviews of trading by directors during the first quarter (Q1) and third quarter (Q3) of each year, beginning with Q1 of 2008.

- there was only a low level of contravention of the trading policies of listed companies, by only a small proportion of the pool of directors.[99]

The ASX has indicated that the reasons for this low contravention rate are that entities may confine the blackout period under their trading policies to a shorter time than that used by the ASX in its reports. Also, many companies under their trading policies permit trading by directors during a blackout period if a waiver is granted, typically by the board or a person delegated by the board, such as the chairman. As indicated in the ASX Q1 2009 survey report:

> The principal reason for the Chairman's approval was that the Chairman was of the opinion that the Director was not in possession of material information that had not been released to the market at the time of the trade.

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99 In summary:

- of the 1,863 [Q1, 2008], 1,418 [Q3, 2008] and 1,047 [Q1, 2009] active trades by directors in the securities of their own companies in those periods, 795 or 42.7% [Q1, 2008], 718 or 50.6% [Q3, 2008], 346 or 33% [Q1, 2009] occurred during the ASX blackout period
- the active trades during the blackout period involved the securities of 381 [Q1, 2008], 331 [Q3, 2008] and 431 [Q1, 2009] entities
- the active trades during the blackout period were made by 556 [Q1, 2008], 454 [Q3, 2008] and 219 [Q1, 2009] directors
- of the active trades during the blackout period, 57 or 7.2% [Q1, 2008], 95 or 13.2% [Q3, 2008] and 35 or 10.1% [Q1, 2009] potentially contravened the trading policies of the entities involved. The ASX sent letters to the entities concerned to ascertain whether a contravention may have occurred
- the majority of responses to the ASX letters indicated that the relevant transactions did not breach the entity's trading policy, as the chair of the board of directors had given the appropriate approval for the trade. However, 6 of the 57 trades [Q1, 2008], 15 of the 95 trades [Q3, 2008] and 8 of the 35 trades [Q1, 2009] were confirmed by the companies as contraventions of their trading policies. The confirmed contraventions involved 5 [Q1, 2008], 12 [Q3, 2008] and 6 [Q1, 2009] individual directors in 5 [Q1, 2008], 9 [Q3, 2008] and 6 [Q1, 2009] entities
- all active changes of interest in contravention of an entity's trading policy have been, or are being, further analysed for possible instances of insider trading and breaches of the continuous disclosure requirements by listed entities. Possible instances will be referred.

3.4 Other jurisdictions

3.4.1 United Kingdom

All trading by directors and other persons discharging managerial responsibilities (PDMRs) in the securities of their UK listed public companies is regulated by the Model Code, issued by the FSA.

The Model Code forms part of the listing rules, which are the responsibility of the FSA. The Code was developed in consultation with exchange and market representatives and is concerned with perceptions of market abuse rather than actual behaviour.[100]

As previously indicated (Section 2.4.2), the general principle under the Model Code is that a PDMR may not deal in any securities of his or her company without obtaining a clearance to deal in advance.

In general, a PDMR cannot be given a clearance to deal during a 'prohibited period', which means:

- any 'close period', or
- any other period when there exists any matter that constitutes inside information in relation to the company.[101]

A close period is:

- 30 days before the announcement of quarterly results if the company reports on a quarterly basis
- the period from the end of a financial period up to and including the time of publication of the results if the company reports on a half yearly basis, and
- in general, 60 days immediately preceding the preliminary announcement of annual results or publication of an annual financial report, or if shorter the period from the end of the

100 *FSA Handbook Notice 85* (February 2009) Section 4.51.
101 para 1(e).

relevant financial year up to and including the time of announcement.[102]

The purpose of the Code in prohibiting trading by PDMRs in the securities of their company during a prohibited period is to ensure that they do not abuse, and do not place themselves under suspicion of abusing, inside information that they may be thought to have through their positions in the company, especially in periods leading up to an announcement of the company's results.[103]

There are exemptions from this prohibition on PDMRs trading in the company's securities during a prohibited period:

- various passive dealings by PDMRs[104]
- sales of securities of the company by a PDMR who is not in possession of inside information about the company and is given clearance to transact because he or she is in severe financial difficulty or there are other exceptional circumstances.[105] The FSA must be consulted at the early stage of any such application for a clearance.[106]

From March 2009, transactions on behalf of PDMRs under non-discretionary trading plans are exempt from the prohibition on trading during a blackout period. These plans are arrangements with independent third parties for the purpose of long-term dealing programs by PDMRs. They cover transactions on behalf of a PDMR where that person has no influence or discretion over how, when or whether to effect transactions under the plan.[107] There is no requirement for pre-clearance before entry into a non-discretionary

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102 para 1(a).
103 *FSA CP08/16 Quarterly Consultation (No 18) October 2008* Section 7.5.
104 Model Code paras 2 and 12–19.
105 Model Code para 9. Model Code para 10 states that a person may be in severe financial difficulty if he has a pressing financial commitment that cannot be satisfied otherwise than by selling the relevant securities of the company. However, a tax liability would not normally constitute severe financial difficulty unless the person has no other means of satisfying the liability. Also, a circumstance will be considered exceptional if the person in question is required by a court order to transfer or sell the securities of the company or there is some other overriding legal requirement for him to do so.
106 para 11.
107 *FSA Handbook Notice 85* (February 2009).

trading plan or transactions under it, though there are other controls, namely:

- a PDMR may not during a prohibited period enter into a non-discretionary trading plan, or amend a plan previously entered into
- a plan may not be cancelled in a prohibited period if the PDMR has inside information at the proposed time of the cancellation
- cancellation otherwise in a prohibited period will only be permitted in the 'exceptional circumstances' referred to in the Model Code, and with the same restrictions as with other 'exceptional circumstances', including that the company has given clearance to cancel the plan and the FSA has been consulted.[108]

Transactions under a permitted trading plan must be disclosed.[109]

The Model Code makes clear that nothing in it sanctions a breach of the insider trading provisions or other relevant legal or regulatory requirements. Trading pursuant to an exception from the prohibition on trading during a prohibited period remains subject to the insider trading laws.[110]

In addition to the above prohibitions or restrictions on trading, the Model Code prohibits PDMRs from entering into investments in the company's securities of a short-term nature. A PDMR cannot be given approval to transact in the securities of the company where the transaction has a maturity of one year or less, effectively prohibiting entering into short-term 'buy then sell' transactions.[111] This has a similar purpose to the US short-swing profit rule (see below).

To prevent PDMRs from circumventing the procedures and restrictions on their trading in their company's securities, the Code imposes various obligations on them, including to prevent a

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108 ibid.

109 ibid.

110 The principles in the UK insider trading laws are summarised in Appendix 3 of the CAMAC Discussion Paper *Insider Trading* (2001).

111 Model Code para 8.

'connected person'[112] from entering into what otherwise would be a prohibited transaction.[113]

The Model Code regulates only dealings by PDMRs. Companies can supplement the Model Code requirements by imposing more stringent restrictions on trading by PDMRs, or adopting more broad-ranging policies applicable to trading in their securities at particular times by all their officers and employees.

The Model Code is set out in Appendix B.

3.4.2 USA

Trading at any time by a person with inside information is subject to the insider trading prohibition.[114] There is an exception enabling directors and other corporate officers to enter into non-discretionary trading plans, under which transactions may take place on a regular basis on their behalf during a period in which they would otherwise be prohibited from trading under the insider trading laws.[115]

Beyond the insider trading laws, there are no rules specifically directed at blackout trading, other than in some specific circumstances related to employee pension plans (see below). It is a matter for each company to determine what policy, if any, to adopt concerning trading by directors or other corporate officers in the securities of the company prior to the announcement of annual or periodic financial results or at any other time.

In practice, it appears that listed companies have in fact implemented blackout trading policies and procedures. One reason for this has been the effect of the *Insider Trading and Securities Fraud*

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112 A connected person is defined in para 1(b).

113 Model Code paras 20–22.

114 The principles in the US insider trading laws are summarised in Appendix 6 of the CAMAC Discussion Paper *Insider Trading* (2001).

115 SEC Rule 10b5-1. This rule permits persons, such as directors and other corporate officers, who are likely to be aware from time to time of inside information concerning the company, to structure their own future trading plans concerning the company's securities, provided that when the plan is devised they are not aware of any price-sensitive information that would be relevant to any future time when the plan is implemented and they have no discretion over its implementation. See further Sections 2.149–2.152 and Appendix 6 of the CAMAC Discussion Paper *Insider Trading* (2001) and Section 2.6 of the CAMAC *Insider Trading Report* (2003).

Enforcement Act of 1988, which obliges companies and other 'controlling persons' to take steps to discourage employees and other 'controlled persons' from engaging in insider trading. Under the Act, a controlling person can be penalised (up to three times the profit gained or the loss avoided by the controlled person) if that person knew, or recklessly disregarded the fact, that a controlled person was likely to engage in insider trading and failed to take appropriate steps to prevent it.[116] A company that failed to adopt, or take reasonable steps to enforce, an effective blackout trading policy could be liable if it transpires that a corporate insider has engaged in insider trading during an information-sensitive period.

The *Sarbanes-Oxley Act of 2002*[117] prohibits any director or executive officer of an issuer of any equity security from directly or indirectly transacting in any equity security of the issuer during any time that the company prohibits its employees, under their pension plans, from trading in the securities of the company. This provision was introduced in response to the perceived inequity of directors and other senior executives being able to trade in Enron's securities during a blackout period imposed by the company on its employees:

> In the *Enron* case, many employees were furious to learn that during a pension fund blackout—and while Enron's stock price was plummeting—senior executives were allegedly cutting their losses by selling large quantities of Enron stock. The employees were prohibited from selling during the blackout.[118]

Also, under the short swing profit rule, companies can recover from directors, executive officers or substantial shareholders any profits they make if they buy, then sell, the company's securities within any 6 month period.[119]

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116 Section 21A of the *Securities Exchange Act of 1934*, introduced by the *Insider Trading and Securities Fraud Enforcement Act of 1988*. This form of derivative liability on a controlling person is further outlined in the CAMAC Discussion Paper *Insider Trading* (2001) in Appendix 6 under **Derivative civil liability**.

117 s 306(a), and consequential amendments to Section 101 of the *Employee Retirement Income Security Act of 1974*.

118 *Securities Regulation* (gilbert Law Summaries, Thomson West, 7th edition 2008) at 365-366.

119 This rule is summarised in the CAMAC Discussion Paper *Insider Trading* (2001) Appendix 6.

3.4.3 Canada

As in other jurisdictions, trading at any time by a person with inside information, including during a blackout period, is subject to the insider trading prohibition.[120]

As in the United Kingdom and the USA, an exception applies for non-discretionary trading plans, though the terms of this exemption differ in some respects from the US provision.[121] There is also an exemption from the insider trading provisions where:

> the purchase or sale was made pursuant to participation in an automatic dividend reinvestment plan, share purchase plan or other similar automatic plan that was entered into by the person prior to the acquisition of knowledge of the material fact or material change.[122]

Beyond that, there is no securities law or regulation prohibiting or restricting trading during 'blackout' periods.

Canadian regulators, however, support the principle of companies developing and implementing their own blackout trading policies. For this purpose, *National Policy 51-201 Disclosure Standards* (the policy statement) provides 'best practice' guidance concerning the establishment by companies of non-trading periods for corporate insiders around earnings announcements. The recommendations in the policy statement are not intended to be prescriptive and companies are encouraged to adopt the suggested measures in a flexible and sensible manner to fit their individual situations.[123]

The policy statement states that companies should:

> adopt an insider trading policy that provides for a senior officer to approve and monitor the trading activity of all your insiders, officers, and senior employees. Your insider trading policy should prohibit purchases and sales at any time by insiders and employees who are in possession of

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120 The principles in the Canadian insider trading laws are summarised in Appendix 7 of the CAMAC Discussion Paper *Insider Trading* (2001).

121 Further details about what is required under permitted automatic (non-discretionary) securities transaction plans are set out in Ontario Securities Commission Staff Notice 55-701 (June 2006).

122 s 175(2)(b) of the OSA General Regulation.

123 Section 1.1(2).

> material nonpublic information. Your policy should also provide for trading "blackout periods" when trading by insiders, officers and employees may typically not take place (for example a blackout period which surrounds regularly scheduled earnings announcements). However, insiders, officers and employees should have the opportunity to apply to the company's trading officer for approval to trade the company's securities during the blackout period. A company's blackout period may mirror the quiet period described above.[124]

The TSX Venture Exchange has also published guidelines relating to blackout periods.[125] They state:

> [a]n Issuer's policy should address trading blackouts. Trading blackouts are periods of time during which designated employees cannot trade the Issuer's securities or other securities whose price may be affected by a pending corporate announcement. A trading blackout:
>
> (a) prohibits trading before a scheduled material announcement is made (such as the release of financial statements);
>
> (b) may prohibit trading before an unscheduled material announcement is made, even if the employee affected doesn't know that the announcement will be made;
>
> (c) prohibits trading for a specific period of time after a material announcement has been made.

These guidelines are also published in and expanded on in Toronto Stock Exchange guidance publications,[126] which state:

> [i]t is easiest to implement a policy on trading blackouts that applies to scheduled announcements, such as the release of financial statements. In this case, the policy might:
>
> - prohibit trading by employees for a certain number of days before and after the release of financial statements

124 id, Sections 6.10 and 6.11.

125 TSX Venture Exchange Corporate Finance Manual, Appendix 3B.

126 Toronto Stock Exchange Policy Statement on Timely Disclosure, at 11 and Toronto Stock Exchange Company Manual—Restrictions on Employee Trading, s 423.8.

- provide "open windows", which are limited periods of time following the release of financial statements during which employees may trade.

It is more problematic to implement a policy on trading black-outs for unscheduled announcements. A company should make the following decisions about its policy on trading blackouts according to its particular circumstances:

- should the policy apply to employees other than those already prevented from trading by insider trading rules (for example, senior employees not directly involved in the material transaction)?

- would telling an employee not to trade tip them off as to the content of the pending announcement?

If a company decides to implement a pre-announcement blackout policy, it might want to consider one of the following options:

- without giving a reason, instruct employees not to trade until further notice if there is a pending undisclosed material development

- require employees to obtain approval before trading, on the understanding that this approval will be denied if any material information has not been disclosed.

A company's policy on post-announcement trading blackouts should:

- state whether the blackout rules apply to all staff or only to those involved in the material transaction

- allow the market time to absorb the information before employees can resume trading. The amount of time that the market needs to absorb the information and set a new price level will depend upon the size of the company and to what extent it is tracked by analysts and investors.

The Exchange also suggests that a company:

- circulate some basic do's and don'ts about employee trading to all their staff

- designate a contact person who is familiar with the disclosure rules and who can help employees determine whether or not they may trade in a given circumstance

- set expiry dates for the exercise of stock options and other such compensation plans so that the expiry dates normally would fall after the release of financial statements

- educate employees about any additional specific trading restrictions that may apply to them (for example, Section 130 of the Canada Business Corporations Act generally prohibits insiders of CBCA companies from selling that company's shares short, or from buying or selling put or call options on the shares. Insiders of companies which have to report under the U.S. Securities Exchange Act of 1934 may be subject to other restrictions, such as liability to account for short swing profits.)

- decide whether employees who are subject to more stringent trading restrictions, and who are not required by law to file insider trading reports, should have to report details of their trading to the company

- decide whether the company should review insider trading reports to make sure that employees have complied with company policy and disclosure rules.

Breaches by individuals of blackout trading policies of particular companies do not, of themselves, constitute offences. However, failure by an individual to adhere to them, even in the absence of proof of insider trading, may be taken into account in administrative proceedings by the regulator to determine whether 'it is in the public interest' to make an order against that person.[127] The Ontario Securities Commission (OSC) has stated that:

> Corporate blackout policies form an important element of securities law compliance by public companies and their insiders. There should be a heavy onus [in administrative disciplinary proceedings] on any insider who trades, or recommends trading, during a blackout period to demonstrate that he or she did so without knowledge of any material fact or material change.[128]

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127 The Ontario Securities Commission has power pursuant to ss 127 and 127.1 of the *Securities Act,* R.S.O. 1990, c.S.5, to consider whether 'it is in the public interest' to make one or more orders against a person, including that the person resign from the position of director or is prohibited from becoming or acting as a director.

128 *Re Melnyk* (2007), 30 O.S.C.B. 5253 at [31].

In recent administrative proceedings, the OSC, in its findings and reasons, has also stated that:

> We do not agree … that blackout periods are simply a matter between an issuer and its insiders. Issuers establish blackout periods to ensure that there will be no trading in the corporation's securities by persons who have access to undisclosed material information until that information has been disclosed to the market and sufficient time has elapsed to permit its evaluation.
>
> We find that [the respondent's] conduct [in trading during a company's blackout period] fell below the standard applicable to a registrant who is both in a senior position at a registered broker and investment dealer and a director of a reporting issuer and a member of its Audit Committee. We find that, in the circumstances of this case, [the respondent's] conduct was abusive of the integrity of the capital markets of Ontario and contrary to the public interest.[129]

3.4.4 Hong Kong

Before April 2009, the Hong Kong Stock Exchange prohibited directors and certain corporate employees of a listed company and those connected with them (Company Insiders) from trading in the company's securities for one month before the publication of annual or interim financial results.

The purpose of this exchange-based requirement was to buttress the statutory insider trading provisions and 'to promote investor confidence by creating requirements to remove, or at least mitigate, any suspicion of abuse by Company Insiders of price-sensitive information that they may have or be thought to have, especially during periods leading up to an announcement of results'.[130]

A perceived problem with the prohibition was that it applied to a limited specified period before the actual announcement by a company of its results. In consequence, the later those results were announced after the end of a reporting period, the more opportunity

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129 *In the matter of Roger D Rowan, and others* (June 20, 2008) at [159]-[160].

130 Hong Kong Exchange and Clearing Limited, *Combined Consultation Paper on Proposed Changes to the Listing Rules* (January 2008), Section 18.12.

there would be for Company Insiders to transact beforehand with an informational advantage.

In early 2008, the Exchange put forward for consultation a proposal to apply the blackout period from the end of each reporting period until the actual announcement of the results, which could be up to seven months each year if a company delayed its reporting to the last possible moment (the 2008 proposal).[131]

The rationale for the 2008 proposal was to promote investor confidence by removing, or at least mitigating, the perception of corporate insiders being able to take advantage of their access to confidential corporate information:

> The current 'black out' period may fail to ensure that Company Insiders do not abuse the market whilst in possession of [inside] information, especially in periods leading up to a results' announcement by the listed issuer and may also not adequately address concerns about the perception of abuse.[132]

The Exchange also stated that, while it was desirable for directors to hold securities in their companies:

> [the Exchange] believes that directors should not be actively and frequently trading in their company's shares, but should be long term investors in the company.[133]

The Exchange noted that Australia and Singapore do not have specified blackout periods, leaving it to each company to set any such period. However:

> … these markets essentially rely on a mixture of insider dealing laws and market forces that result in companies setting tight internal controls. However, it may be argued that neither of these factors may work sufficiently well in Hong Kong and therefore it is necessary to set a formal benchmark by tightening the Exchange Listing Rules for companies to follow.[134]

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131 id at 18.17–18.18.
132 id at 18.13.
133 id at 18.20.
134 id at 18.16.

It was also noted that:

> The ownership structure of many Hong Kong listed issuers is not comparable with that in other relevant jurisdictions. It is widely recognised that Hong Kong has a large proportion of listed companies which are family owned and managed.[135]

Following a consultation period, the Exchange decided to go ahead with the 2008 proposal concerning blackout trading rules.[136] However, in the face of widespread opposition to the proposed length of the ban on trading by Company Insiders of affected companies,[137] the Exchange modified the proposal. It remained of the view that:

> … the current rule on the black out period, providing for a one month restricted period, is insufficient to bolster investor confidence by reducing suspicions of abuse by company insiders of information that they might have or might be thought to have leading up to a results announcement.[138]

Under the modified proposal, which became operative in April 2009, directors and other insiders of a listed company are prohibited from transacting in securities of that company within 60 days [previously one month] before the company reports its annual earnings.[139] The 30 days restriction before a company reports its interim results remains unchanged.

> The modified proposal is an extension of the black out period applicable to the publication of an issuer's annual financial results from one month to 60 days. The black out periods for half year and other interim periods will be 30 days, in line with the current requirement of one month. To assist the Exchange in monitoring the revised black out

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135 Opening remarks by Richard Williams, Head of Listing, Hong Kong Stock Exchange to the Legislative Council Financial Affairs Panel, 30 December 2008.

136 Hong Kong Exchange and Clearing Limited *Consultation Conclusions Proposals in the 2008 Combined Consultation Paper* (November 2008) at [284].

137 For an analysis and outline of reactions to the proposal, see J Brewer, 'Let there be light' *Csj Viewpoint* February 2009 at 24–27. See also Chee Keong Low, 'Extending the black out period on share trading by directors in Hong Kong: in whose court does the ball lie?' (2009) 27 C&SLJ 184.

138 Hong Kong Exchanges and Clearing Limited *News release* 12 February 2009.

139 Legislative Council Panel on Financial Affairs, *Issues related to the proposed extension of the "blackout" period and introduction of quarterly financial reporting* (26 February 2009).

> arrangements issuers will be required to give prior notification to the [exchange] Listing Division of the imminent commencement of any black out period relating to the publication of financial results.[140]

The new rule, like its predecessor (but unlike the 2008 proposal), relates to the period before the actual announcements by companies. In consequence, the later a company chooses to report, the greater the opportunity to have a non-blackout period for some time after the end of a reporting period.

3.5 Matters for consideration

The Issues Paper raised for consideration a series of questions concerning the implications of blackout trading for market integrity and whether further initiatives were necessary to regulate this trading.

These issues, and a summary of responses in submissions, are set out below.

3.5.1 The implications of blackout trading for market integrity

Some submissions considered that blackout trading did not raise market integrity concerns, as:

- trading during a blackout period does not necessarily involve insider trading. For instance, a director without inside information may wish to trade in the company's shares during a blackout period because of financial hardship
- the ASX 2008 surveys indicate that only 1% of trades contravened the blackout trading policies of companies, in that approvals or waivers had been granted for the vast bulk of these trades
- the ASX reviews trading at or before the time of significant announcements to the market (whether or not during a blackout period) and refers suspicious trading to ASIC.

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140 Hong Kong Exchanges and Clearing Limited *News release* 12 February 2009.

However, some respondents were concerned about the level of trading by directors in the shares of their companies during periods preceding the release of financial results. In this regard:

- there was a view in some submissions that trading during a blackout period can undermine investor confidence though a *perception* of insider trading, even in the absence of improper conduct

- some respondents were concerned about the lack of transparency of the grounds upon which waivers were given to permit trading during a blackout period

- some respondents raised concerns about the apparent lack of sanctions against a director for breaching a company's blackout trading policy.

3.5.2 Possible approaches

The Issues Paper asked whether it would be beneficial for the ASX Corporate Governance Council *Principles and Recommendations* to provide further guidance to companies about their approach to blackout trading or whether a more interventionist approach should be adopted.

There was a considerable range of views in submissions on what additional measures, if any, were required.

(a) No change

One view in submissions was that the voluntary ASX Corporate Governance Council guidelines, combined with the statutory and listing rule requirements that impinge on blackout trading, provide a sufficient, and balanced, regulatory approach. Any underlying impropriety in blackout trading is dealt with by the insider trading, and other market misconduct, provisions, while various disclosure provisions applicable to these trades keep the market informed.

Given this regulatory background, each company should be left to formulate its own blackout trading policies, appropriate to its size, structure and nature.[141] Also, companies could use the appendices under ASX Listing Rule 3.19A to disclose more fully the circumstances in which they have given approvals for blackout period trades pursuant to their trading policies.

It was also argued that the continuing ASX surveys on directors' trading in shares during blackout periods may lead to improved levels of disclosure by companies on how they apply their blackout trading policies and exemptions.

(b) Development of Corporate Governance Council Principles

Some respondents proposed that the Corporate Governance Council *Principles and Recommendations* be further developed to provide greater guidance, or recommendations, to companies on developing, and publishing on their website, a more detailed blackout trading policy.

Matters to be covered in a more expansive discussion of blackout trading could include:

- appropriate blackout periods
- the securities affected by blackout trading guidelines
- the transactions in those securities that are exempted, including, for instance, acquisitions under rights issues or employee share

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141 For instance, it was suggested in submissions that a company's blackout trading policy statement should cover the following matters:
- the prohibition on insider trading
- directors' interests notification
- 'clearance to deal' procedures
- awareness of and compliance with the policy
- restrictions on trading in company securities that breaches legal and regulatory requirements
- the role of the company secretary
- the risks that the entity's policy is meant to address
- the consequences if the policy is breached
- a statement whether and in what circumstances any exemptions will apply, in particular:
  - such circumstances should not extend beyond genuine hardship (which would not cover a potential tax liability) or a court order or similar requirement
  - if those exemptions do not apply, the policy must state that any exemption is at the chairman's discretion
  - exemptions should be approved by the board or the chairman.

schemes, acceptances under takeover offers or transactions where the beneficial interest does not change

- a statement of expectation that, apart from exempt transactions, directors and other affected individuals within the company will refrain from actively trading in company shares during blackout periods

- the criteria that affected individuals must satisfy to obtain a clearance to undertake a blackout trade, such as personal financial hardship, and who within the company can grant these approvals to trade

- details of procedures to ensure adequate mechanisms for supervision and compliance with the company policy.

If further guidance were considered beneficial, companies could, for instance, be encouraged to:

- periodically re-evaluate the length of a blackout period and the range of persons covered, taking into account any changes in a company's business and personnel over time

- ensure that persons subject to a blackout period are aware of the restrictions on their trading, for instance requiring them to certify that they have read, and will comply with, the company's blackout trading policy.

To help reassure the market that clearances are based on justifiable grounds, the guidance could also indicate that any clearances to trade during the blackout period should be disclosed, either immediately or at the latest in the company's annual report, with details of:

- the relevant director or other person

- the shares traded

- the reason the clearance was granted.

(c) Amendment to Listing Rules concerning disclosure

Some respondents proposed, independently of any changes to the ASX Corporate Governance Council *Principles and Recommendations*, that the ASX should consider requiring companies whose boards provide a waiver to a director to trade during a blackout period to announce to the market whenever that discretion has been exercised: for instance, it could add the following questions to the ASX Appendix 3X, 3Y and 3Z Notice Forms:

- were the shares in question traded during a period where trading would not normally be permitted under the company's trading policy?
- if yes, did the board exercise its discretion to allow the trade to proceed during the restricted period?

Another respondent favoured revising the 'Nature of Change' box in the Appendix 3Y form to include a section that prompts companies to disclose:

- the governance exercised by the company
- in the case of atypical trades which would be most likely to involve perception risk of insider trading—the rationale for the trade. While there may be privacy concerns about disclosing the rationale, directors and companies would remain free to determine when the rationale is disclosed and the level of detail disclosed, with greater disclosure being advisable for a trade likely to be perceived as insider trading.

Another submission proposed that Appendices 3X, 3Y and 3Z be modified to:

- record when the transaction was approved and who approved it
- rectify current areas of lack of clarity, such as:
  - dates and prices on notices not according with transactions reported on those dates
  - sales and purchases being combined into a net amount without separate disclosure
  - several days' trading being amalgamated in one contract note
  - contract notes being delayed because the order is incomplete

  - several brokers being used

- require disclosure of volume, price and broker IDs of groups of transactions for each trading date, with this information to be available to investors or their advisers at a minimal cost.

One respondent argued that, where a company has lodged a defective notice under ASX Listing Rules Appendices 3X, 3Y or 3Z, ASIC or the ASX should have the power to require the company's auditors to provide corrected notices, with the request for new notices being immediately disclosed to the market.

(d) Greater regulation of blackout trading

Some respondents supported a move beyond the voluntary 'if not, why not' ASX Corporate Governance Council approach in the direction of a requirement, either in the Listing Rules or the legislation, that all listed companies must have, and must publish, a blackout trading policy, with an obligation to inform the market of all waivers granted and the grounds of waiver.

There was also some support for the UK Model Code approach, which, through the listing rules, imposes detailed and uniform controls on blackout trading for listed entities, including mandatory restrictions on trading in the company's shares by directors and other senior executives during certain defined periods. Some respondents also supported a further requirement for companies publicly to disclose when, why and to whom, permitted waivers have been granted.

It was argued that an externally imposed approach to blackout trading based on the Model Code would:

- promote investor confidence by reducing both the perception of insider trading and any opportunity for undetected insider trading. This would also reduce any speculation or rumour that directors and other corporate officers trading in a blackout period were aware of confidential price-sensitive information concerning the company

- assist directors and executives to answer accusations of impropriety for their trading in the company's shares

- through uniform regulation, provide certainty for corporations and the market in regard to blackout trading and permitted waivers
- largely remove the internal corporate responsibility for decision-making on waivers, given the restricted grounds for permitting waivers.

There were differing views on whether any permitted waivers should also require the approval of the ASX or alternatively the approval of ASIC.

One submission said that the ASX should refer all instances of active director trading during blackout periods to ASIC for investigation, with the legislation imposing a reverse burden of proof on directors to demonstrate that they did not trade whilst in possession of inside information.

3.6 Advisory Committee position

The starting point for any consideration of trading by directors, executive officers or other corporate officers during particular periods of price-sensitivity is that anyone who is aware of confidential price-sensitive information is subject to the prohibitions on insider trading. This restriction on trading applies at all times, regardless of whether a company has stipulated particular blackout trading periods for all or some corporate officers and whether the trading in question falls within or outside this period.

In addition, the statutory obligation upon directors to disclose their trading in their company's securities brings about some transparency. The market is informed and the disclosure can provide a basis for public questioning or comment or for follow-up and investigation by ASIC or the ASX of questionable transactions. The Advisory Committee has elsewhere recommended strengthening of that disclosure requirement by extending it to all dealings in the securities of a company, by executive officers as well as directors, and shortening the disclosure period (Section 2.9 **Market disclosure of approved dealings**).

Notwithstanding this legal framework, the practice of directors or officers transacting in the securities of their company at times close to the release of financial results or when, as it turns out, the company held inside information, can create the perception that some level of insider trading has taken place. This can be exacerbated by the difficulties in detecting or proving particular instances of insider trading, including proof that the person trading was aware of the inside information. The overall effect can be a reduction in confidence in the integrity of the market.

The ASX surveys indicate a seemingly high incidence of active trading by directors in the period between the close of the company's books and the release of half-year or full-year results. This is a matter of concern, notwithstanding the ASX's observation that the trading only rarely breached the blackout trading policies of the companies surveyed, in some cases because the company had a shorter blackout trading period and in other cases because a waiver had been granted. There is limited satisfaction to be had from knowing that some companies have policies restricting trading in narrower periods, or that waivers were granted in a seemingly large number of cases on the basis of a judgment that the director was not aware of inside information.

Whatever the particular circumstances, the fact that a large proportion of the overall trading by directors in the shares of their company takes place during times when they can be presumed to be better informed than the market about forthcoming results is not likely to engender confidence. The point of blackout periods is that directors should not trade during those times, other than in exceptional circumstances, not simply that they should be refused a waiver when they hold inside information.

In light of concerns that still remain about the level of active trading by directors and other officers during periods of particular market sensitivity, the Committee considered a range of policy responses, including the law and practice in other jurisdictions and the possible approaches discussed in submissions.

In the Committee's view, it is in the interests of a company, as a matter of good and responsible governance and to maintain the confidence of investors, to adopt a disciplined approach to trading by its corporate officers in the company's securities during price-sensitive periods.

The ASX Corporate Governance Council *Principles and Recommendations* have gone some way towards encouraging such an approach, but still leave it to each company to determine its own blackout policy.

The Committee is of the view that particular constraints should apply to trading by directors and executive officers. They occupy a privileged position in relation to a company's affairs. They are likely to have access to its most sensitive internal information and, in effect, the company's knowledge can be imputed to them. They should neither abuse their privileged position nor be seen as abusing it.

Current governance recommendations call for a company to disclose its blackout trading policy to the market, but leave the content of that policy to the company. Variable approaches to the length of blackout periods and differing approaches to granting waivers do not promote market confidence.

As a matter of good governance and in the interests of market integrity, there should be a more prescriptive approach to the trading by directors and executive officers in the securities of their company during sensitive periods.

The Committee considers that a listed company, as a matter of best practice, and to promote confidence in the trading of its securities, should:

- prohibit its directors and executive officers from transacting in its securities in the period between the close of its books and the release of half-year or full-year results and at any other times, at the initiative of the company, when it is aware of, or has under consideration, a market-sensitive matter (such as an unannounced takeover proposal or other still-confidential negotiation) (blackout periods). Various passive transactions should be exempt from this prohibition[142]

- permit a director or executive officer to dispose of securities in a blackout period only where that person is not aware of inside information and is in severe financial difficulty or other exceptional circumstances exist. A person designated by the

[142] This covers dealings which are exempt from the proposed 'disclose and deal only if permitted' requirement, as discussed in Section 2.9.

company to grant a waiver should be required to consult with the ASX or ASIC (depending upon whether the requirements are introduced by the ASX or in legislation: see below) before granting any waiver

- keep a record of any waivers given.

It should be open to a company to adopt a more restrictive policy where it sees fit.

Company policies may also impose trading restrictions on other levels of corporate officers. For these employees, who are less exposed to inside information, there may be greater room for discretion about the content and operation of a blackout trading policy, including in the granting of waivers.

This proposed best practice approach should also make clear that the granting of a waiver to a director or executive officer to transact during a blackout period is subject to the application of the insider trading laws and does not sanction a breach of those provisions or any other relevant legal or regulatory requirements.

Directors and executive officers who are given a waiver to trade during a blackout period would be required to disclose those dealings to the market under s 205G (amended as proposed elsewhere[143]).

The Committee, in an earlier report and again in this report, has recommended an exemption from the insider trading provisions for transactions under non-discretionary trading plans, in line with approaches in other jurisdictions.[144] This exemption is designed to permit directors and other corporate officers to plan for the future and have transactions in the company's securities entered into on their behalf provided they have no influence or discretion over those transactions.

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143 See Section 2.9 **Market disclosure of approved dealings**.

144 In the UK, there is an express exemption from the blackout trading period for non-discretionary trading plans. Trading under non-discretionary trading plans is recognised in US and Canadian law as an exemption from their insider trading prohibitions: see Section 3.4.2 [USA] and Section 3.4.3 [Canada]. The CAMAC *Insider Trading Report* (2003) Section 2.6 and rec 16 proposed a carve-out from the Australian insider trading provisions for non-discretionary trading plans.

Transactions on behalf of directors or executive officers under these trading plans should also be exempt from the prohibition on trading during the blackout period.[145] The Committee notes the controls in the UK over entry into, amendment of or cancellation of a trading plan, to prevent abuse.[146] Also, and notwithstanding that transactions under a plan will be executed by the third person administering the plan, the transaction would be treated as a transaction by the relevant director or executive officer for the purpose of their disclosure to the market of all dealings in securities (see further Section 2.9).

One way to strengthen the response to blackout trading would be for the ASX Corporate Governance Council to introduce in its *Principles and Recommendations* the best practice approach referred to above for directors and executive officers. Companies would be obliged, at least, to adopt and follow this best practice approach or explain why not (the 'if not, why not' reporting requirement).[147]

There is a question whether an 'if not, why not' approach would suffice in this key area of market integrity. While responsible companies are likely to follow or go further than recommended practice, other companies may be reluctant to place constraints on when their directors and executive officers can deal in the securities of the company.

The ASX could consider whether this best practice approach to blackout trading is sufficiently central to corporate governance and market integrity to be adopted in its Listing Rules. This would go beyond the ASX Corporate Governance Council approach by making the elements of this best practice approach obligatory for all listed entities. These entities could also be obliged under the Listing Rules to make such internal arrangements as are necessary to ensure compliance by directors and executive officers with the prohibitions on their trading during blackout periods.

In the absence of effective implementation in a governance context, a legislative approach could be considered.

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145 In the UK, transactions under non-discretionary trading plans are exempt from the blackout trading prohibition: see Section 3.4.1.

146 See further Section 3.4.1.

147 ASX Listing Rule 4.10.3.

A more rigorous approach to trading by directors and executive officers during sensitive periods will help bolster investor confidence and market integrity. It would also serve as an effective adjunct to the enforcement of insider trading laws by denying the opportunity for directors and executive officers to transact in the securities of their company during particular price-sensitive periods. It may reduce the opportunity for undetected insider trading.

The Committee notes that, in the USA, the *Insider Trading and Securities Fraud Enforcement Act of 1988* imposes civil liability on various 'controllers', including listed companies, where 'controlled persons' engage in insider trading. This appears to have encouraged companies to implement and enforce compliance practices including through blackout trading policies. While there is some attraction in that approach, the Committee does not see a need to pursue it in the light of the other proposals in this report and the already onerous nature of our insider trading laws.

For completeness, the Committee refers to the further restriction in the UK Model Code on short-term transactions by PDMRs in the securities of the company, and the short-swing profit rule in US law. Both are aimed at curbing short-term speculative trading by key corporate insiders in the securities of their companies. There is an argument that directors and executive officers should be longer-term investors in the company. Entry by them into short-term transactions opens the possibility, or perception, of their speculating in the securities of their company, with self-interest considerations driving short-term corporate outcomes. This issue has not been pursued in this report.

4 Spreading false or misleading information

This chapter considers whether changes are required in the regulatory framework to deal with the spreading of false or misleading information. It outlines relevant legislative provisions and regulatory approaches and compares the position in Australia with other countries. It looks at possible measures to assist in enforcement of the law, including expanding the civil penalty regime, as well as means to assist in the prevention and detection of rumour-mongering, including further obligations for market licensees. It also discusses the provision of guidance for target companies and recipients of rumours.

4.1 The Minister's request

The Minister's letter states:

> During the recent market turbulence, concerns have been raised that some market participants may have been spreading false or misleading information in respect of certain securities in order to take advantage of artificial changes in their price. This practice is sometimes referred to as 'rumourtrage'.

The Minister's media release said:

> On the issue of false rumours or 'rumourtrage', concerns have been raised amid recent market turbulence that some market participants, here and overseas, may have spread false information to deliberately drive down a particular company's share price.
>
> In light of the concerns raised, it is appropriate to review the regulatory regime governing such rumours and market manipulation, with specific focus on the spreading of false information.

The Minister has asked CAMAC to:

- examine how overseas jurisdictions regulate the spread of false or misleading information, and compare and contrast overseas regulation with that of Australia; and

- advise whether changes are required to Australia's regulatory framework and, if so, what form they should take.

4.2 Context

Financial markets feed on information. A fundamental thrust of the legal and regulatory framework for our market in securities is to promote transparency through the disclosure of timely, relevant and accurate information by listed companies and others. Nevertheless, it is always possible for inaccurate or misleading information to emerge or be circulated, and there will be opportunities for the mischievous use of such information by market participants in their own interests, including by the promotion or spreading of such information through rumour. At times of heightened market uncertainty and volatility, the harmful effects of such conduct are likely to be pronounced and can further destabilise the market.

The legislative prohibitions on behaviour that will compromise the integrity of the information available to the market are important for market confidence. These prohibitions need to be supported by a range of appropriate sanctions (criminal and civil liability, civil penalties, and banning orders). There is also a need for companies and financial market licensees to take steps to ensure compliance, including by developing internal processes to curb the undue further dissemination of rumours.

One way in which the flow of information to the market can be distorted is through the spreading of rumours. A rumour essentially involves unverified information, or information without a reasonable basis, purporting to be fact. It differs from the expression of an opinion, such as an analyst's view of the prospects of a company, derived from information provided by the company or others.

Rumours have the potential to distort markets and undermine market confidence. For instance, they can be used by short-sellers to drive down a company's share price. In late 2008, the financial crisis gave rise to concerns in Australia and other markets that short sellers were using rumours to drive down the price of particular stocks. In some cases, it should be said that what were first regarded as rumours turned out to have an element or more of truth.

The Minister's request refers to concerns about market participants taking advantage of the creation and spreading of rumours. In considering these matters, it is necessary to consider the position of those who initiate and spread rumours in the market, how targets of rumours respond to them and how other market participants and intermediaries respond.

4.3 Initiating rumours

4.3.1 Current position

There is no lack of relevant legislation in this area. Various provisions in the Corporations Act may apply to persons who generate false or misleading rumours about securities, to take advantage of consequent changes in their price.

Section 1041E, in particular, prohibits the making of a materially false or misleading statement, or the dissemination of materially false or misleading information, that is likely to induce trading, or affect the price of trading, in any securities where the disseminator knows, or ought reasonably to have known, that the statement or information was materially false or misleading, or does not care whether it is false or misleading.

Other relevant provisions include:

- the prohibition on market manipulation (creating or maintaining an artificial price for trading in financial products): s 1041A

- the prohibitions on false trading and market rigging (creating a false or misleading appearance with respect to the market for, price of or extent of active trading in financial products or engaging in fictitious or artificial transactions that create a price that is not set by the market): ss 1041B, 1041C

- the prohibition on inducing a person to deal in a financial product through false, misleading or deceptive statements, dishonest concealment of material facts or storing false or misleading information to which other persons will have access: s 1041F

- the prohibition on a person who is carrying on a financial services business engaging in dishonest conduct in relation to a financial product or financial service: s 1041G

- civil liability for misleading or deceptive conduct: s 1041H.

The prohibitions in s 1041E, as well as those in ss 1041F and 1041G, impose criminal liability, thereby requiring proof of breach beyond reasonable doubt. Failure to comply with any of these provisions may also lead to civil liability to affected individuals.[148] However, they are not civil penalty provisions. By contrast, the other provisions (ss 1041A, 1041B, 1041C), as well as imposing criminal liability, are also civil penalty provisions,[149] with the lower civil standard for proof of breach.

Following concerns expressed to ASIC about the possibility of some individuals deliberately spreading false or misleading information about securities in particular listed companies, ASIC initiated an investigation into allegations of market manipulation, including through the dissemination of false rumours (Project Mint).[150] ASIC has also taken action to ban a trader for a contravention of s 1041H.

The ASX may seek information from listed entities for various purposes, including in relation to market rumours. It is an offence under s 1309 for an officer or employee of a corporation knowingly to provide to an operator of a financial market any information relating to the affairs of that corporation that is materially false or misleading. That officer or employee must also take reasonable steps to ensure that this information is not materially false or misleading.

The ASX Corporate Governance Council *Principles and Recommendations* do not appear to address the spreading of rumours directly, although Principle 3 (promote ethical and responsible decision making), Principle 5 (make timely and balanced disclosure) and Box 5.1 (suggestions for the content of continuous disclosure policies) may be of general relevance.

4.3.2 Other jurisdictions

UK and other EU countries

The dissemination of false rumours constitutes 'market manipulation' within the meaning of the European Union (EU)

148 s 1041I.
149 ss 1317DA, 1317E.
150 ASIC Media Release *08-47 False or misleading rumours* (6 March 2008).

Market Abuse Directive[151] (the EU directive), which applies in the United Kingdom and other EU member States. The EU directive defines market manipulation to include:

> [the] dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to financial instruments, including the dissemination of rumours and false or misleading news, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading.[152]

The prohibition of market manipulation and other forms of market abuse is reflected in UK legislation administered by the FSA.[153]

The FSA has various investigative powers (supported by criminal sanctions for non-compliance), including compelling the provision of information.[154] These statutory powers can be used to investigate the spreading of rumours or other forms of market abuse. Also, as required under the EU directive, to assist in tracking down market abuse, UK firms are required to inform the FSA of trading that raises a reasonable suspicion of market misconduct:

> A firm which arranges or executes a transaction with or for a client in a qualifying investment admitted to trading on a prescribed market and which has reasonable grounds to suspect that the transaction might constitute market abuse must notify the FSA without delay.[155]

Under a requirement introduced in March 2009, broking firms in the United Kingdom are required to record, and retain for six months, telephone conversations and other electronic communications (including by fax and email) that involve receiving client orders and negotiating, agreeing and arranging transactions in the equity, bond,

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151 Directive 2003/6/EU of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse).

152 Article 1.2(c).

153 *Financial Services and Markets Act 2000* s 118. See further, FSA 2005/15 *Market Abuse Directive Instrument 2005*.

154 *Financial Services and Markets Act 2000* Part XI: Information gathering and investigations.

155 See FSA 2005/15 *Market Abuse Directive Instrument 2005,* Section 15.10.2. Annex E of this Instrument implements Articles 7–11 of EU Commission Directive 2004/72/EC (April 2004), which, in turn, implements Article 6(9) of the EU *Market Abuse Directive* 2003/6/EC in regard to the notification of suspicious transactions.

financial commodity and derivatives markets.[156] This goes beyond current EU requirements.[157] Prior to this, broking firms were only required to maintain electronic records of trading requests from clients until settlement of transactions.

The FSA requirements are aimed at market abuse generally, not specifically rumour-mongering, and are designed to augment its other information-gathering powers. The FSA points out that market abuse is one of the most difficult offences to investigate and prosecute and that good quality recordings of voice conversations and electronic communications may help in the detection and deterrence of inappropriate market behaviour:

> Records of phone conversations and electronic communications can play an important role in investigations of market abuse by providing context and helping to establish facts. Taped records can provide evidence of knowledge and intent—crucial elements in building an enforcement case but not always easy elements to establish.[158]

The FSA expects that a recording requirement will reduce the profit incentive to commit market abuse and will have various economic benefits:

- it may increase the probability of successful enforcement
- better enforcement would reduce the expected value to be gained from committing market abuses, leading, in principle, to increased market confidence and greater price efficiency.[159]

However, this requirement is limited in scope. The FSA has indicated that it would not ordinarily expect that the conversations of research analysts, retail financial advisers or persons carrying on

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156 FSA Policy Statement 08/01 *Telephone Recording: recording of voice conversations and electronic communications* (March 2008). See also FSA 2008/6 *Conduct of business sourcebook (recording of telephone conversations and electronic communications) Instrument 2008*.

157 It is anticipated that the EU will report by 2010 on whether, or in what circumstances, to require recording of various conversations. The focus of the EU review appears to be on consumer protection issues for clients of brokers, rather than more general market abuse and enforcement issues.

158 FSA *Market Watch* June 2008 at 1.

159 id at 2.1.

back-office functions would be captured.[160] Also, corporate finance business and corporate treasury functions are excluded.[161] Furthermore, the recording obligation only relates to conversations that are intended to lead to the conclusion of an agreement, not to general conversations about market conditions.[162] In addition, the requirement does not cover the use of mobile phones, due to current technological difficulties in recording conversations by people using them. However, it appears that this exemption will be subject to further review as developments in technology make such recording more practicable.[163]

By way of comparison with the UK approach, it is noted that the requirements in the Corporations Act to record telephone conversations during a takeover bid were repealed on the basis that they did not increase the protection of security holders and imposed significant costs on the parties involved.[164]

USA

There is a broad prohibition on market manipulation in connection with the purchase or sale of securities in the United States. This prohibition would include persons knowingly spreading false rumours that may be manipulative. SEC Rule 10b-5, a general anti-fraud provision enacted pursuant to s 10(b) of the *Securities Exchange Act of 1934*, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:
>
> (1) To employ any device, scheme or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, or

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160 id at 2.15.
161 ibid.
162 id at 2.18.
163 id at 2.29.
164 Explanatory Memorandum to the Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007 at 6.5.

(3) To engage in any act, practise, or course of business which operates or would operate as a fraud or deceit on any person,

in connection with the purchase or sale of any security.

The provision can be enforced through criminal prosecution or through civil proceedings initiated either by the SEC or by a private party who can prove standing, reliance on the rumour and loss causation. There are also stock exchange rules that prohibit the circulation of false or misleading information.[165] In practice, enforcement has generally been by way of civil proceedings, though recent developments in the US market may lead to greater resort to criminal prosecutions.

There is a range of provisions that can be relevant to the intentional dissemination of false rumours. For instance, the SEC recently relied on the provisions relating to the use of interstate commerce or the mail to defraud or deceive,[166] false or misleading statements in relation to securities dealings[167] and the use of manipulative or deceptive devices in relation to securities dealings,[168] as well as the

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165 For instance, NYSE Rule 435(5) prohibits the circulation of false or misleading rumours 'of a sensational character which might reasonably be expected to affect market conditions' and NASD Rule 5120(e) prohibits the circulation of any information which is false or misleading or which would improperly influence the market price of a security.

166 Section 17(a) of the *Securities Act of 1933* (this provision is similar in many respects to Rule 10b-5).

167 Section 9(a)(4) of the *Securities Exchange Act of 1934*.

168 Section 10(b) of the *Securities Exchange Act of 1934*.

general anti-fraud provision,[169] in a case brought against a trader relating to the spreading of false rumours.[170]

The SEC has on foot a major investigation into possible market misconduct, following reports of trading irregularities and allegations of false rumour-mongering, abusive short selling and possible manipulation of financial stocks. In announcing the investigation, the SEC noted that:

> Abusive short selling, market manipulation and false rumor mongering for profit by any entity cuts to the heart of investor confidence in our markets.[171]

The SEC may pay a bounty out of money recovered as penalties for insider trading to persons who provide information leading to the imposition of the penalty.[172] There is no similar power available in the market manipulation area at this stage.

Canada

The dissemination of false or misleading information is an offence under the securities legislation in each of the Provinces. For instance, s 126.2(1) of the Ontario *Securities Act* R.S.O. 1990, provides:

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169 Rule 10b-5 of the *Securities Exchange Act of 1934*.

170 In 2008, the SEC charged Paul Berliner, a Wall Street trader, with securities fraud and market manipulation for intentionally spreading false (but plausible) rumours, through instant messages, about The Blackstone Group's acquisition of Alliance Data Systems (ADS) while selling ADS short. The false rumour was also picked up by the media. The rumour caused heavy trading in ADS stock (more than twenty times the previous day's trading volume) and a 17% decline in its price. In response to the unusual trading activity, the New York Stock Exchange temporarily halted trading in ADS stock. Later in the day, ADS issued a press release announcing that the rumour was false. By the close of trading, the price of ADS stock recovered to its pre-rumour price. Berliner profited by short selling ADS stock during its decline. The case was settled, with Berliner consenting to a judgment enjoining him from future violations of the antifraud and anti-manipulation provisions of the federal securities laws, and requiring him to disgorge his profits, together with interest, pay a penalty of $130,000, and consent to the entry of a Commission Order barring him from association with any broker or dealer. See 'SEC Charges Wall Street Short Seller With Spreading False Rumors' *SEC Press Release* 2008-64 (24 April 2008) and *Litigation Release* No 20537 (24 April 2008).

171 *SEC Press Release 2008–214* (19 September 2008).

172 Section 21A(e) of the *Securities Exchange Act of 1934*. See further J Austin, 'A rapid response to questionable trading: Moving towards better enforcement of Australia's securities laws' (2009) 27 C&SLJ 203 at 212–213.

> [a] person or company shall not make a statement that the person or company knows or reasonably ought to know,
>
> (a) in a material respect and at the time and in light of the circumstances under which it is made, is misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading; and
>
> (b) would reasonably be expected to have a significant effect on the market price or value of a security.

4.3.3 Matters for consideration

1 The implications for market integrity of rumour-mongering

There was a general recognition in submissions that rumour-mongering has an adverse effect on market integrity. Respondents pointed out that:

- rumours, or unverified information in relation to entities, lead to inefficiencies in the pricing mechanism for securities and can lead to increasing price volatility in already turbulent markets
- false rumours, while most obviously affecting falling markets, can also be used to promote a security price
- the spreading of rumours is contrary to the fundamental principle that the market should be fair, efficient and transparent
- rumour-mongering can mislead and destabilise markets and undermine trust in them.

However, it was also pointed out that it can sometimes be difficult to distinguish between opinion and rumour and some rumours may have some element of truth or be based to some degree on verified information.

2 Sections 1041E, 1041F and 1041G as civil penalty provisions

The Issues Paper raised the question whether ss 1041E, 1041F and 1041G should be redrafted as civil penalty provisions (as well as remaining criminal provisions).

Most submissions supported, or did not object to, making ss 1041E, 1041F and 1041G civil penalty provisions, which can be enforced through civil penalty proceedings involving no criminal fault element. Reasons given included:

- it would ensure that ASIC has the full range of regulatory options (administrative, civil, civil penalty and criminal) in responding to rumour-mongering
- the inhibitions on bringing enforcement actions caused by the difficulties in establishing the criminal burden of proof for offences can undermine market integrity. Adopting civil penalty provisions to assist the enforcement process is preferable to making the offences easier to prosecute in criminal proceedings
- it would maximise the chances of a successful action, including by removing the need to prove the mental element for criminal liability
- the civil burden of proof could encourage greater compliance
- it would be consistent with the possibility of civil recovery under s 1041I and other Corporations Act market manipulation provisions.

One respondent considered that ss 1041E and 1041F, but not s 1041G, should be civil penalty provisions, given the central ‘moral blameworthy’ element of dishonesty in s 1041G.

3 Broader review of market misconduct provisions

Some submissions saw merit in a more general review of the market misconduct provisions in ss 1041A–1041G, including their fault elements, arguing that these provisions:

- have been derived from various sources and have evolved in a piecemeal way over time
- are inadequate for the prosecution of manipulative trading offences
- cover similar but not identical ground and should be rationalised
- have failed to keep pace with changes in the marketplace, being based on provisions enacted before the emergence of electronic communications and when Australian trading floors were

state-based and open outcry, before electronic trading of securities, mobile phones and the Internet.

It was also argued that the interaction of these provisions with ss 1041H, 1308 and 1309 is unclear.

The Law Council of Australia proposed that in lieu of these various provisions there should be a single general anti-fraud sanction that:

- applies to statements that relate to dealings in securities
- is a civil penalty provision as well as a criminal provision
- has a fraud standard for criminal liability and a negligence standard with a due diligence defence for civil liability.

One submission supported lifting the 5 year maximum prison penalty to 10 years, in line with the proposed penalty for illegal cartel activity. Another submission argued that long-lasting penalties, such as banning brokers, provide a greater deterrent than fines.

4 Compulsory recording of electronic forms of communication

The Issues Paper raised the question whether some form of compulsory recording of telephone conversations and other electronic forms of communication, such as SMS, should be introduced, noting recent FSA initiatives in the UK.

Support compulsory recording

Some submissions supported compulsory recording of telephone conversations and other electronic forms of communication, arguing that it would:

- help to deter rumour-mongering and other market abuses
- help in insider trading and market manipulation investigations
- clarify facts in any investigations into false or misleading statements

though it was recognised that cost may be a significant factor and that parties could still seek to evade detection by using alternative communication channels.

However, it was suggested that this could be partly countered by a ban on the use on trading floors of mobile phones and any other devices that cannot be recorded or taped.

Equivocal about compulsory recording

Some respondents were equivocal about the utility of taping phone conversations, considering that the costs to industry and regulators would have to be weighed against possible benefits.

Oppose compulsory recording

Most submissions opposed compulsory recording of telephone conversations and other electronic forms of communication, such as SMS. They doubted whether it was possible to achieve a workable and effective regime for mandatory recording, pointing to the cost and limited application of any recording requirement. Also, any compulsory recording requirement could:

- impose significant additional costs on industry (including the cost of infrastructure, tape storage and retrieval)
- add to the cost and complexity of investigation by providing regulators with too much information to review, which can result in matters being overlooked and/or significant delay in completing an investigation.

It was also argued that:

- a similar requirement in relation to takeovers was repealed in 2007, as it was ineffective in protecting shareholders and imposed significant costs
- communications would move to forms of communication that are not recorded
- overseas or unregulated market participants may not be captured by the compulsory recording regime
- the UK FSA has acknowledged that recording will have a limited effect on the detection of rumour-mongering
- it would involve an invasion of privacy
- it would be difficult to determine how long recordings should be retained. Currently, recordings are retained for a short time (for

instance, T+3) to assist in resolving trading errors or disputes. A longer retention period would increase the cost to brokers and add complexity to normal document retention practices

- it is unlikely to capture all communications (for instance, it may only relate to execution of client orders, not general discussions about market conditions or company/sector performance) or apply to communications of all persons in a position to initiate and/or spread rumours.

5 Other regulatory initiatives

Submissions suggested other regulatory initiatives to deal with rumour-mongering.

Licensing

ASIC proposed that:

- s 912A(1) be amended to require holders of Australian Financial Services Licences (licensees) who deal or advise in securities to have guidelines on rumour-mongering to ensure responsible discussion of information about listed entities
- s 920A(1) be amended to permit ASIC to make a banning order against persons who contravene the licensee's guidance on rumour-mongering.

Another submission suggested some conditions that could be imposed as a requirement for holding a licence:

- licensees must have controls and procedures reasonably designed to give effect to their obligation to ensure that their representatives do not spread false or misleading statements (s 1041E)
- licensees must identify and report to ASIC any conduct contrary to the obligations of their representatives pursuant to s 1041E.

That respondent argued that it is more flexible to impose conditions of this nature on licensees and give them freedom to choose whether to adopt recording or some other method of giving effect to the obligation than to require them to record all telephone conversations and other electronic forms of communication.

Another respondent favoured a condition that a licensee inform ASIC of the receipt and source of a statement or information that is materially false or materially misleading, with provision for qualified privilege for the person informing ASIC.

Interception of electronic communications

Some respondents were of the view that, instead of compulsory recording of some or all electronic communications, it may be more effective to amend the *Telecommunications (Interception and Access) Act 1979* to permit ASIC to obtain a warrant to intercept telephone or other electronic communications, at least in relation to an investigation of any form of market misconduct, as:

- the rationale for a similar proposed power for the Australian Competition and Consumer Commission (ACCC) in relation to cartels, that the existence of cartels is more difficult than other forms of corporate misconduct to discover and prove, applies equally to market manipulation (including the spreading of false rumours) and insider trading

- in the absence of evidence that ASIC could obtain under such a warrant, it would be in the difficult position of having to make out a circumstantial case where it could prove that telephone calls were made, but not what was said

- it would be a better deterrent than compulsory recording of telephone conversations, as perpetrators would not be aware or able to find out if their conversations, on any line, were being recorded.[173]

Providing information to clearing or settlement bodies

It is an offence under s 1309 for an officer or employee of a corporation knowingly to provide to an operator of a financial market any information relating to the affairs of that corporation that is materially false or misleading. That officer or employee must also take reasonable steps to ensure that this information is not materially false or misleading.

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173 See further J Austin, ‘A rapid response to questionable trading: Moving towards better enforcement of Australia’s securities laws’ (2009) 27 C&SLJ 203 at 210–211.

ASIC has proposed that these requirements also apply to an officer or employee providing information to a clearing or settlement operator, such as the clearing subsidiary of the ASX.

Immunity or leniency policy

Some respondents suggested that there should be an immunity or leniency policy for participants in offences who become whistleblowers, as:

- the ACCC has a policy to this effect in relation to cartels, applicable where the whistleblower:
  - is the first to report the activity
  - is not the leader of the cartel, and
  - did not coerce others to join the cartel
- the US Securities and Exchange Commission has a leniency policy and the UK Financial Services Authority has a policy of considering cooperation in deciding whether to prosecute an individual for market misconduct: a similar approach by ASIC would therefore ensure a more consistent and coordinated enforcement response.

It has been suggested that any problems associated with evidence from a person granted immunity may be ameliorated if ASIC is given telephone intercept powers that it could use to obtain the corroboration necessary to secure a conviction.[174]

Corporate compliance system

One respondent suggested amending the listing rules as follows:

- require, as a condition of relying on the exceptions to disclosure in Listing Rule 3.1A, that:
  - the corporation has a compliance system (the requirements for which could be mandated or described by the ASX or

[174] See further J Austin, 'A rapid response to questionable trading: Moving towards better enforcement of Australia's securities laws' (2009) 27 C&SLJ 203 at 211–212.

ASIC), registered with the ASX, for providing reasonable assurance that confidential information is kept confidential

  – the directors certify in the annual and half yearly accounts that such a compliance system exists

- where this certification exists, place the onus on an outside party to establish that the compliance system has failed
- where this certification does not exist, create a presumption that a false market exists where a rumour about a corporation is communicated and require the corporation promptly to confirm or deny the rumour.

A compliance system may assist in identifying the source of a rumour.

4.4 Target response to rumours

Rumours may be created and spread for various purposes including to misinform the market about the true financial position of a company, with the intention of artificially deflating or increasing the market price of its shares. Other rumours may be circulated in an attempt to force a target company to acknowledge or disclose market-sensitive information otherwise exempt from disclosure requirements. An example would be a rumour concerning an incomplete proposal or negotiation that up to that point had not been publicly disclosed, in reliance on an exception to the continuous disclosure obligation under the ASX Listing Rules.[175]

The way in which companies respond to rumours about them can have significant consequences for the market.

4.4.1 ASIC

ASIC has issued guidance on how companies should deal with market rumours affecting their securities. In *Heard it on the grapevine* (1999), it said:

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[175] ASX Listing Rule 3.1A.3 exempts incomplete proposals or negotiations from the continuous disclosure requirements in Listing Rule 3.1.

> Listed companies are sometimes asked to comment on market rumours with potential to affect their share price. Company disclosure policies should direct requests of this type to the corporate disclosure manager. The safest initial response to requests to comment on this type of rumour is always to say 'we do not respond to market rumours'.[176] The corporate disclosure manager will then need to assess whether a public announcement is warranted in the circumstances. Policies on responding to rumours should aim for consistency: saying 'we do not respond to market rumours' on some occasions and at other times indicating there is no substance in a rumour may send a signal to the market.[177]

Also, in *Better Disclosure for Investors—Guidance Rules* (2000), which followed consultation on *Heard it on the grapevine*, ASIC said, in Principle 7, that companies must 'develop procedures for responding to market rumours, leaks and inadvertent disclosures. Even if leaked or inadvertently disclosed information is not price-sensitive, give investors equal access by posting it on the company website.'

More recently, ASIC has noted that:

> companies do not want to be drawn into a situation where they are practically obliged to respond to every rumour, particularly as the substance nears the truth and a simple 'no' is not sufficient. It is, however, clear that just ignoring rumours will not work in this market. There will be some stories that have achieved such widespread fame, or infamy, that they must be confronted: the company must advise the ASX of the rumour and the true position to prevent there being a false market. Other stories will be close to the mark, and these will need to be affirmed to the market. The litmus test … is the false market.

Also:

> One thing is very clear: when dealing with rumours, the company and its advisers must not engage in selective disclosure of material information. It is not enough for you to call your major institutional desks, or the journalists, to set the story right, and rely on them to spread the word. That

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176 Unless the request comes from ASIC or the stock exchange, in which case a substantive response must be given.

177 para 46.

> is just war by 'counter-rumour'. If the information is price-sensitive, then everyone must be told it, through the ASX platform.[178]

4.4.2 ASX

The ASX has indicated that, if there is market rumour or speculation, it may require the entity to respond, to ensure that the market is trading on fully informed basis.[179]

ASX Guidance Note 8 states, in relation to market speculation:

> ASX does not expect an entity to respond to all comments made in the media, or all market speculation. However when the market moves in a way that appears to be referrable to the comment or speculation, and the entity has not already made a statement in response, ASX would be likely to ask the entity for information or clarification to ensure that the market remains properly informed, or correct or prevent a false market in the entity's securities … Similar principles may apply in relation to speculation posted on forums such as internet bulletin boards or 'chat room' sites.
>
> Generally, in determining whether an announcement is required, ASX will examine the context in which the media comment or speculation occurs, the details and materiality of the information and the likely reaction of the market or the entity's share price to the information. ASX will also take into account previous relevant announcements by the entity and previous relevant media commentary. Where the media comment expresses the view or supposition of analysts or market commentators about a likely strategy or transaction and there is no apparent movement in the share price or volume, it is not likely that ASX will form the view that an announcement is required. Where the media comment appears to be reporting in specific detail a material change in strategy or that a material transaction is to occur, the source of the comment appears referable to those involved, and there is an apparent or likely movement in the share price or volume, ASX is likely to take the view that an announcement would be required.

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178 Speech by ASIC Commissioner Belinda Gibson to the Australasian Investor Relations Association 2008 Annual Conference 27 November 2008.

179 ASX Guidance Note 8 para 89.

> ASX does not generally require the disclosure of trade secrets, internal management documents or incomplete negotiations that an entity is entitled not to disclose. But it is ASX policy that, whatever the information, and however much it might otherwise have been reasonable not to disclose it, the information should be released to the whole market once it becomes known to any part of the market. In any event, the exception from listing rule 3.1 no longer applies, as the information is no longer confidential.
>
> Entities are encouraged to develop procedures for responding to rumours and speculation in the media and other forums, refer ASIC *Better disclosure to investors* guidance principles and ASX commentary.

Also, under Listing Rule 3.1B, the ASX can require a listed entity to give it information needed to correct or prevent a false market.

4.4.3 ASX Corporate Governance Council

The ASX Corporate Governance Council *Principles and Recommendations* contain no specific recommendation in relation to target response to rumours. However, Box 5.1 in Principle 5 (suggestions for the content of continuous disclosure policies) may be of some general relevance to target companies in determining whether and how to respond to rumours about them.

4.4.4 AIRA

The Australasian Investor Relations Association (AIRA), *Best Practice Investor Relations: Guidelines for Australasian Listed Entities* (May 2006) states that:

> Listed companies should develop a written policy for dealing with rumours and market speculation. Generally, companies are encouraged not to comment on rumours and market speculation.
>
> Companies should set out their policy with regards to working with the ASX in instances in which market or media speculation on material information has occurred.[180]

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[180] At 17.

4.4.5 Other jurisdictions

United Kingdom

The FSA *Market Abuse Directive*[181] sets out various principles for targets in dealing with rumours about themselves, on the basis that the more accurate a rumour, the more likely it is that there has been a breach of confidentiality and that disclosure is required as soon as possible:

- where there is press speculation or market rumour regarding an issuer, the issuer should assess whether a disclosure obligation arises. To do this, an issuer will need to assess carefully whether the speculation or rumour has given rise to a situation where the issuer has inside information

- where press speculation or a market rumour is largely accurate and the information underlying the rumour is inside information, it is likely that the issuer can no longer delay disclosure, as it is no longer able to ensure the confidentiality of the inside information

- an issuer that finds itself in the circumstances described above should disclose the inside information as soon as possible

- the knowledge that press speculation or market rumour is false is not likely to amount to inside information. Even if it does amount to inside information, the FSA expects that in most of those cases an issuer would be able to delay disclosure (often indefinitely).[182]

Canada

The *National Policy 51-201 Disclosure Standards* provides non-prescriptive guidance on responding to rumours:[183]

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181 FSA *Market Abuse Directive (Disclosure Rules) Instrument 2005* (FSA 2005/16) and *DTR 2.7 Dealing with rumours*

182 See also FSA *Policy Statement regarding the implementation of the Market Abuse Directive provisions* (PS05/03) Section 3.15: Market Rumour.

183 Section 1.1(2) indicates that the recommendations in the guidance are not intended to be prescriptive and companies are encouraged to adopt the suggested measures in a flexible and sensible manner to fit their individual situations.

> Adopt a 'no comment' policy with respect to market rumours and make sure that the policy is applied consistently. Otherwise, an inconsistent approach may be interpreted as 'tipping' [under the Canadian insider trading provisions]. You may be required by your exchange to make a clarifying statement where trading in your company's securities appears to be heavily influenced by rumours. If material information has been leaked and appears to be affecting trading activity in your company's securities, you should take immediate steps to ensure that a full public announcement is made. This includes contacting your exchange and asking that trading be halted pending the issuance of a news release.[184]

4.4.6 Matters for consideration

The general view in submissions was that the principles in ASIC Regulatory Guide 62 *Better Disclosure for Investors* and ASX Corporate Governance Council Box 5.1 in Principle 5 sufficed. No further guidelines were necessary.

ASIC indicated in its submission that it will consider whether the principles in its Regulatory Guide 62 *Better Disclosure for Investors* need to be refreshed.

4.5 Recipients of rumours

4.5.1 Current position

Rumours can influence a market to the extent that persons who hear them act on them or pass them on to other market participants.

A recipient of a rumour needs to take care in determining any response. That person would be at risk of criminal liability under the insider trading provisions if he or she traded and was aware, or ought reasonably to have known, that the rumour contains confidential price-sensitive information.[185] As observed by the Advisory Committee in its *Insider Trading Proposals Paper* (2002):

> The current definition of inside information includes any 'matters of supposition' that may materially affect the price

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[184] Section 6.14.
[185] The key provision is s 1043A.

> or market value of particular financial products, whether in fact true or not. Recipients of rumours or speculation may breach the current insider trading prohibition by trading in affected securities, unless the rumour or speculation is sufficiently widespread that it is 'generally available' or is sufficiently disbelieved that it is not price-sensitive.[186]

Also, a recipient of a rumour would be at risk of criminal liability from passing it on if it contains a statement or information that is materially false or misleading and is likely to influence market conduct and the recipient either knows or should know that the statement or information is materially false or misleading or does not care whether the statement or information is true or false.[187]

4.5.2 Other jurisdictions

United Kingdom

The FSA has undertaken a review of industry practice in this area.[188] It identified various policies that particular firms have adopted in dealing with rumours. The FSA considers that these policies could be incorporated into a possible best practice model along the following general lines:

- *compliance with regulatory requirements:* for instance, a requirement that any employee receiving a rumour obtain compliance advice about the legality of either trading in affected securities or passing on the rumour
- *trading based on rumours:* for instance, a requirement for the prior approval of senior management before trading based on rumours
- *conditions on which rumours can be passed on*: for instance, requirements for the prior approval of senior management before any rumour can be communicated and that any comment by the target of the rumour be included

186 Section 1.33.
187 s 1041E.
188 See further UK FSA *Market Watch* Issue No 30, November 2008, 'Thematic review: Rumours'.

- *the form in which rumours can be passed on:* for instance, a requirement that it be made clear that the communication is a rumour and involves unverified information purporting to be fact
- *training and monitoring:* how employees are made aware of best practice policies and how their conduct is monitored to check adoption of those policies.

USA

In late 2008, the Financial Industry Regulatory Authority (FINRA) published a draft rule regulating how brokers and dealers (market intermediaries) should deal with the further circulation of rumours received. Following public consultation, FINRA has published an amended proposed rule:

> No member shall originate or circulate in any manner a rumor concerning any security that the member knows or has reasonable grounds for believing is false or misleading and is likely to influence the market price of such security. If a member learns of a rumor that the member knows or has reasonable grounds for believing was originated or circulated for the purpose of improperly influencing the market price of a security, the member must promptly report the rumor to FINRA.[189]

FINRA recognises the need for market intermediaries to discuss rumours received in a responsible fashion. It proposes a series of permissible communications by market intermediaries:

- where the rumour has been widely circulated in the media and its source and unsubstantiated nature are disclosed
- where any communication between market intermediaries concerning a rumour is necessary to explain market or trading conditions, provided the communication is not intended to influence the price movement of affected securities and is undertaken in a responsible way (including sourcing the rumour where possible, not embellishing it and presenting it in as neutral and balanced a way as is practicable under the circumstances)

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189 FINRA Regulatory Notice 09-29: *Origination and Circulation of Rumors* (June 2009). Comment on the proposed rule was sought by 16 July 2009.

- where market intermediaries hold internal discussions on a rumour, provided this is undertaken solely for the purpose of verifying or inquiring into the truthfulness or accuracy of a rumour and where its unsubstantiated nature and, where possible, its source are disclosed.[190]

FINRA is also proposing that market intermediaries be required to maintain adequate written policies and supervisory procedures reasonably designed to identify and address the circulation of rumours. This includes training policies and programs reasonably designed to ensure that employees and other associated persons of market intermediaries comply with their responsibilities and obligations concerning the origination and circulation of rumours.[191]

FINRA is engaged in a consultative process and is expected to settle its position in the latter part of 2009.

4.5.3 Matters for consideration

Respondents pointed out that it is difficult to prevent people from talking about rumours that they have received. Indeed, clients will expect their brokers to tell them everything that they have heard about the stock. Also, in modern electronically mediated markets, where information and share trading occur at extremely fast rates, information that is less than perfect or fully researched is often passed on. It would be stifling if participants in a market felt that they were prohibited from passing on information that was not extensively checked for veracity.

The Issues Paper pointed out that one way to assist recipients in responding to rumours may be through the development of best practice guidelines on their treatment by market intermediaries, such as brokers, and by other significant market participants, including investment funds.

The ASIC submission indicated that it plans to develop 'good practice' guidelines, taking into account the UK FSA guidance and practice in the US market.

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190 ibid.
191 ibid.

4.6 Advisory Committee position

The promotion of market transparency through the disclosure of relevant information is a key factor in maintaining a fair and efficient market. We have in Australia a generally robust regime for disclosure. This is a starting point in considering possible additional measures to help counter rumours. The more timely and reliable the information available to the market, the less scope there is for the successful dissemination of false rumours.

The intentional spreading of false rumours is inimical to the maintenance of a fair, efficient and transparent market. The mischievous dissemination of rumours can be misleading, destabilising and harmful to the interests of other investors. While the market will never be free of rumour, egregious conduct should be pursued and eliminated where possible.

1 *Initiating rumours*

The Corporations Act already has a number of provisions relevant to the perpetration of false rumours or other forms of market misconduct. While there does not appear to be an obvious gap in the coverage of the existing Corporations Act provisions dealing with rumour-mongering and other forms of market misconduct, the Committee notes that these provisions have evolved in a piecemeal manner and there is scope for a review to rationalise them and ensure a more consistent approach.

The Advisory Committee notes that the Law Council of Australia supports the principle of harmonizing market misconduct liability laws, which could involve replacing the specific provisions in Part 10 Division 2 of the Corporations Act with a generic anti-fraud provision. In the USA, there is a more general anti-fraud provision relevant to false or misleading information or unverified information.

The difficulty in dealing with market manipulation through the spreading of rumours is in large part one of enforcement. Given the nature of the conduct, there are difficulties in the way of uncovering evidence and in proving the elements of an offence.

The Committee sees this as an area where, notwithstanding the difficulties, an active approach to enforcement is called for, including prompt response and investigation of suspect conduct while the evidence and memories are still fresh.

The Committee has given consideration to a range of measures to aid compliance and law enforcement.

Sections 1041E, 1041F and 1041G as civil penalty provisions

The integrity of financial markets would be further strengthened by making ss 1041E (making false or misleading statements) and 1041F (inducing persons to deal) civil penalty provisions and, for that purpose, amending them to remove the fault elements (including any fault elements and standards of proof that might be implied by the Criminal Code), in line with ss 1041A–1041C, which are also civil penalty provisions.

The Committee would also favour making s 1041G (engaging in dishonest conduct) a civil penalty provision if it were possible to cast it in suitable terms, given that the criminal concept of dishonesty is a central element of the offence as it stands.

Compulsory recording of electronic forms of communication

It is important for the effective regulation of the market that market licensees keep appropriate records of transactions, and that regulators have the power to obtain access to those records where necessary. Current record-keeping obligations do not generally include maintaining recordings of actual conversations, though brokers may still record various telephone conversations relating to securities transactions for their own purposes.

While there are benefits for market participants (in the event of dispute), as well as for the regulation of the market, in retaining recordings of conversations, the Committee is not proposing an across-the-board requirement for market intermediaries to record their electronic communications. A move in that direction would need to be considered carefully on a cost-benefit basis.

Licensing

In the Committee's view, it would, however, be appropriate for ASIC to be empowered to impose various record-keeping and other obligations to enhance compliance efforts and assist in any investigative and enforcement process. There may be a need for an amendment of s 912A(1) to enable ASIC to require licensees to:

- have guidelines on rumour-mongering, including policies and procedures to deal with rumours received, to ensure responsible discussion of information about listed entities
- report to ASIC any suspected rumour-mongering or other form of market misconduct of which the licensee or any employee becomes aware.

The Committee also supports an amendment to s 920A(1) to permit ASIC to make a banning order against persons who contravene the licensee's guidance on rumour-mongering.

Interception of electronic communications

ASIC can request the Australian Federal Police to exercise powers under the *Telecommunications (Interception and Access) Act 1979* to intercept telephone conversations in the case of suspected 'serious offences', which include offences punishable by a penalty of imprisonment for at least 7 years.

The Committee considers that, given the importance of maintaining market integrity and the generally surreptitious nature of market misconduct, the various forms of market manipulation, including insider trading and rumour-mongering, warrant being treated as 'serious offences' for the purposes of the interception legislation.

ASIC has proposed a further step to enable it to obtain access to telephone interception on its own behalf. The Committee understands that such powers are proposed for the ACCC in relation to cartel conduct. The Committee has not formed a judgment on any policy issues that may be involved in that further step, but recognises the potential value of such a power in the regulatory armoury.

Providing information to clearing or settlement bodies

It is an offence under s 1309 for an officer or employee of a corporation knowingly to provide to various parties, including an operator of a financial market, any information relating to the affairs of that corporation that is materially false or misleading. That officer or employee must also take reasonable steps to ensure that this information is not materially false or misleading. While this provision covers the ASX, it does not cover bodies that conduct clearing and settlement operations.

The Committee sees this provision as an important practical means of underwriting the integrity of information supplied to market operators. It supports an amendment to extend its operation to information given to a clearing or settlement operator. This would assist in the tracking and investigation of market transactions.

Immunity or leniency policy

The Committee notes that it would be open to ASIC to consider immunity or leniency policies as part of its enforcement strategy. Policies of this kind can play a part in an effective enforcement strategy and have been employed in Australia (for instance, by the ACCC) and in other countries.

2 Target response to rumours

Issuer companies may face difficult matters of judgment in determining whether or in what manner to respond to rumours about them. While they may have a general policy of not commenting on rumours, there may be circumstances where the rumour indicates that some leakage of confidential price-sensitive information has taken place or there is some other danger of the market being misinformed. In those circumstances, companies may feel compelled to respond to rumours. This is an area where care is always required, given the possibility that rumours can be floated in mischievous ways to provoke a response.

ASIC, the ASX and various industry bodies have provided some guidance in the past on how to respond to these rumours. This is a practical issue in the market and it would be timely for this guidance to be revisited, taking into account the approaches in some other countries.

3 Recipients of rumours

The recipient of a rumour that contains confidential price-sensitive information is already potentially subject to the prohibitions on trading, or passing on the information, under the insider trading provisions.

Also, some of the proposals put forward by the Committee to enhance the licensing requirements would apply where brokers or other market intermediaries receive rumours. Licensees could be required to have policies and procedures to deal with rumours received and to ensure responsible discussion of information about listed entities. They could also be required to report any suspected rumour-mongering or other form of market misconduct to ASIC.

In other circumstances, there is little regulatory guidance on how market participants should deal with rumours they receive. On the one hand, it is unrealistic to expect market participants to ignore rumours or not to discuss them with others, particularly where their presence can help explain certain market movements. On the other hand, trading on the basis of speculation that a rumour may have some truth, or in anticipation of further market movement as a rumour continues to circulate, or simply passing on a rumour, can accentuate its effect and thereby further distort the market, with consequential effects on market confidence.

It is understood that ASIC is proposing to undertake a consultation process, with a view to publishing best practice guidelines for the market on how to respond to rumours received. The Committee considers that this is an area where further guidance would be useful, taking into account approaches in other countries, including in the United Kingdom and the United States.

5 Corporate briefings to analysts

This chapter looks at the role of corporate briefing of analysts in the operation of the financial market, as well as relevant law and regulatory guidelines in Australia and in other countries. It considers whether additional regulation is necessary to ensure confidence in the fairness of the financial market.

5.1 The Minister's request

The Minister's letter states:

> Analysts, and the research they perform, play an important role in Australia's financial markets, by keeping the market informed. Briefings are sometimes provided by companies to analysts on a confidential basis to assist in the pricing of securities in the market and to assist with research.
>
> Under the continuous disclosure obligations in the Corporations Act and the ASX Listing Rules, price-sensitive information must be provided to the market once the company becomes aware of it. Continuous disclosure both ensures that the market is fully informed and contributes to market fairness and efficiency. Alternative ways in which market-sensitive information may be distributed include press briefings and posting information on the company's website.
>
> There are concerns, however, that confidential briefings are being provided to analysts which create the perception that some analysts have access to critical information that is not available to other analysts, shareholders and the general public. These perceptions can lead to a lack of confidence in the integrity of Australia's financial markets and potentially create opportunities for insider trading.

The Minister has asked CAMAC to:

- examine the role that briefings of analysts play in Australia's financial market, including whether their role is a positive one that leads to greater market efficiency
- advise whether changes may be required to Australia's regulatory framework and, if so, what form they should take.

5.2 Briefing of analysts

5.2.1 Role of briefings

Corporate briefings, whether initiated by the company or at the request of analysts, can be a means by which analysts gain a greater understanding of a company's financial and other circumstances for the purpose of formulating commentaries and recommendations or informing institutional investment decisions. Financial journalists are included on some occasions.

In this context, an analyst is anyone who reviews information concerning a company for the purpose of formulating commentaries or conclusions on the financial or other state of the company, which may be accompanied by recommendations regarding equity or debt investment in the company. Analysts may be employed by broking, investment advisory or other financial intermediary firms to provide advice for client trading. Other analysts may be employed by institutional investors or other financial entities to guide their trading opportunities and strategies.

Some briefings take place on a regular basis, others in response to particular developments or events. In practice, it is common for companies to initiate briefings of analysts in conjunction with the public release of periodic financial results, or the announcement of other material corporate developments. Others may be held from time to time to provide analysts with an opportunity to hear from the management team about progress and prospects of the business or in response to specific requests.

5.2.2 Types of briefings

Companies may choose to brief analysts in any number of ways. While the number of persons present at, or otherwise having access to, briefings may vary, in practice a distinction can be drawn between briefings that, in effect, are open or accessible to anyone with an interest and those that are of a more private nature.

Open briefings

Companies sometimes arrange briefings for analysts on the basis that those with an interest may attend and that the information provided by the company (and possibly any interchange with persons present at the briefing) is also made more generally available to the market. This may involve advance notification of a briefing, with unrestricted access or the provision of some publicly accessible electronic or other means of obtaining the information provided at the briefing.

These types of briefings can provide a valuable means of disseminating information to the market through the presentation of material, and questions and answers, in elaboration of information provided to the market by formal release. While participants and observers may have differing abilities to understand and analyse information provided at these briefings, they are entitled to draw their own conclusions and act on them.[192]

The ASX Corporate Governance Council recommends that listed entities consider webcasting or teleconferencing analyst or other briefings or posting a transcript or summary of the transcript on the website.[193] Likewise, the Australasian Investor Relations Association (AIRA) has indicated that equity of access to information, including the content of briefings to analysts, is best achieved by dissemination of information to the widest range of audiences, using all available technologies.[194]

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192 The prohibition on insider trading does not include deductions, conclusions or inferences made or drawn from information which is generally available: s 1042C(1)(c).

193 *Corporate Governance Principles and Recommendations* (2nd edition, 2007) Box 6.1.

194 *Best Practice Investor Relations: Guidelines for Australasian Listed Entities* (May 2006) at 4. Those guidelines also recommend (at 8–10) that:
- an analysts' briefing that coincides with a results announcement to the ASX be webcast through the organization's website
- webcasts of listed entity events be widely publicised beforehand (for instance, through the entity's website or an announcement to the stock exchange) so that all interested parties may participate
- recordings of webcasts be made available on the entity's website to enable a replay of the event to occur
- as a matter of good practice, listed entities should lodge a copy of all investor presentations with the exchange(s) on which the issuer is listed.

However, it has been suggested that relatively few results-related briefings are publicly accessible in this way.[195]

Private briefings

Other corporate briefings are carried out on a more closed or private basis, for selected invitees, and without the content of the briefing being made more generally available.

Private briefings may range from structured corporate presentations to a select group of analysts or other interested parties, through to informal and unstructured private face-to-face or electronic communications between an analyst and a corporate officer, often in response to particular queries or requests from the analyst.

It seems that companies often brief analysts on a private basis. A poll of ASX top 200 companies in 2005 found that:

- 98% of the 68 respondent companies held one-on-one meetings
- 97% of the respondent company chief executive officers and 89% of the chief financial officers attended the one-on-one meetings
- of the companies holding private briefings, 63% did not place any conditions on the meetings and 40% still hosted them during blackout periods
- one company suggested that one-on-one meetings were the most frequently used communication tool and were very effective. Another company thought that one-on-one meetings were one of the best ways to ensure that analysts understand the company properly. Others suggested that these meetings would assist in building rapport with fund managers and brokers. One company indicated that content was generally focused on broad strategy,

[195] G North, 'Closed and private company briefings: Justifiable or unfair?' (2008) 26 C&SLJ 501 at 515 states that, based on an empirical study by the author of listed Australian company reporting for the 2004–2005 financial year, 'only a small minority of Australian listed companies currently provide open access to their result-related briefings and conference calls, with advance notice of the briefing access details'.

growth opportunities and gaining a greater understanding of the nature of the industry and operations of the business.[196]

5.3 Legal position of briefings to analysts

Companies are subject to various legislative prohibitions and obligations in their communication with analysts. In addition, the ASX Corporate Governance Council *Principles and Recommendations* are relevant.

5.3.1 Insider trading

In general, a person in possession of confidential price-sensitive information concerning a company's securities is precluded from either trading in those securities (or procuring another to trade) or providing that information to another person who the informant knows, or reasonably should know, will trade in those securities (or procure another to trade).[197]

These prohibitions place constraints on the information that a company can include in a briefing to analysts or the use that analysts can make of information provided.

The company

Companies may refer to, or provide analysts with, any information that is already 'generally available'.[198]

However, a company, through its corporate officers, should not directly or indirectly disclose any inside information, being information that is materially price-sensitive and is not generally available,[199] if the persons disclosing the information know, or ought reasonably to know, that the recipient would, or would be likely to,

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196 Australasian Investor Relations Association (AIRA), *Snap Poll, One-on-One Meetings with Analysts and Fund Managers* (15 June 2005), cited by G North, 'Closed and private company briefings: Justifiable or unfair?' (2008) 26 C&SLJ 501 at 510.

197 The general principles in the Australian insider trading laws are set out in the CAMAC Discussion Paper *Insider Trading* (2001). See also the CAMAC *Insider Trading Report* (2003).

198 s 1042C.

199 s 1042A, definition of 'inside information'.

trade in affected securities or procure some other person to do so.[200] Inside information is broadly defined to include matters of speculation, matters that are insufficiently definite to warrant being made known to the public, and matters relating to the intentions, or likely intentions, of any person, including the company.[201]

A company that inadvertently discloses inside information during a briefing to analysts could reduce or overcome its potentially harmful effect by immediately placing that information in the public arena. Information becomes 'generally available', and persons aware of it can lawfully trade in affected securities, once it is made known in a manner that would be likely to bring it to the attention of the investing public and a reasonable period for its dissemination has elapsed.[202] For disclosing entities, this could be achieved through a continuous disclosure notice to the exchange.

Analysts

Analysts are free to make deductions or draw conclusions or inferences from any generally available information and either themselves trade or recommend others to trade.[203]

However, analysts who receive inside information are subject to restrictions on either themselves trading in affected securities[204] or passing on the inside information to other persons who are likely to trade.[205]

5.3.2 Continuous disclosure

Companies that are disclosing entities must comply with the continuous disclosure obligations.[206] It is a matter for each disclosing entity to determine whether any information provided at a briefing to analysts also needs to be disclosed under the continuous disclosure provisions. For instance, confidential price-sensitive information otherwise exempt from these disclosure obligations,[207]

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200 s 1043A(2).
201 s 1042A, definition of 'information'.
202 s 1042C.
203 s 1042C(1)(c).
204 s 1043A(1).
205 s 1043A(2).
206 Corporations Act ss 674–678, ASX Listing Rule 3.1.
207 ASX Listing Rule 3.1A contains various exceptions to the disclosure requirements.

but which is intentionally or inadvertently disclosed in a briefing to analysts, would lose the element of confidentiality and would have to be disclosed to the market through a continuous disclosure notice.

5.3.3 Market misconduct

Any information provided by a company, whether in an open or private briefing, is subject to the prohibitions on the dissemination of materially false or misleading information and improperly seeking to induce persons to deal in particular securities.[208]

5.3.4 ASX Corporate Governance Council

The ASX Corporate Governance Council *Principles and Recommendations* make no specific recommendations on corporate briefings to analysts. However, the matters set out in Principle 5 (make timely and balanced disclosure) and Principle 6 (respect the rights of shareholders) and Box 6.1 (using electronic communications effectively) may be of some general relevance to governance and disclosure practices in relation to briefings of analysts.

5.4 Regulation of briefings in other jurisdictions

5.4.1 United Kingdom

There are statutory prohibitions on insider trading, applicable to the providers and recipients of confidential market price-sensitive information.[209]

The FSA position is that whenever a corporation, or a person acting on its behalf, discloses any inside information to a third party, then, unless the third party owes the corporation a duty of confidentiality, the corporation must make complete and effective public disclosure of that information, simultaneously in the case of an intentional disclosure and as soon as possible in the case of an unintentional disclosure.[210]

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208 The elements of these offences are set out in ss 1041E, 1041F.

209 The principles in the UK insider trading laws are set out in Appendix 3 of the CAMAC Discussion Paper *Insider Trading* (2001).

210 DTR 2.5.6 and 2.5.7.

Under the UK Takeovers Code, all shareholders and other relevant parties must have equal access to information about a takeover offer. This requires that no meeting between shareholders or other interested parties and representatives of the bidder or target or their advisers may take place unless in the presence of an appropriate third party who can vouch to the Panel that no new material information was forthcoming. If new information emerges, all shareholders and other persons with information rights must be notified as soon as possible.[211]

5.4.2 USA

The SEC, partly in response to the limited reach of the US insider trading laws where there are selective disclosures of material non-public information in private briefings to analysts, introduced a rule (Rule 100 *Selective disclosure and insider trading,* also known as Regulation FD) designed to regulate the communication of information by a company on a selective basis.

The US insider trading laws are based on fiduciary duties of confidentiality owed to the owner of inside information. In general, analysts owe no fiduciary duty of this nature to a company merely because inside information is disclosed to them at a briefing. An analyst receiving inside information in a private corporate briefing would breach the provisions only in limited circumstances for either trading after having received the information, or passing on the information to a client or other person for their trading. In consequence of *Dirks v SEC* 463 US 646 (1983), a case involving the disclosure of inside information to an analyst, it would have to be established in any action against the analyst that the corporate insider who provided the inside information would receive a direct or indirect personal benefit from doing so:

> Thus, an insider can reveal material non-public information, as long as there is no quid pro quo.[212]

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211 UK Takeovers Code Notes on Rule 20.1 (Equality of information to shareholders and persons with information rights).

212 *Securities Regulation* (gilbert Law Summaries, Thomson West, 7th edition 2008) at 257. See further CAMAC Discussion Paper *Insider Trading* (2001) Appendix 6, *Who are insiders* and *Liabilities of insiders*. That Appendix also sets out the facts of *Dirks v SEC*.

The Australian insider trading laws do not have this fiduciary link. Anyone in possession of inside information, including an analyst, or anyone informed by the analyst, is precluded from trading.

Regulation FD states that, whenever an issuer, or person acting on its behalf, discloses material non-public information to certain enumerated persons (in general, securities market professionals or holders of the issuer's securities who may well trade on the basis of the information), the issuer must make public disclosure of that same information:

- simultaneously (for intentional disclosures), or
- promptly (for non-intentional disclosures).

The SEC commentary points out that Regulation FD:

> requires that when an issuer makes an intentional disclosure of material nonpublic information to a person covered by the regulation, it must do so in a manner that provides general public disclosure, rather than through a selective disclosure. For a selective disclosure that is non-intentional, the issuer must publicly disclose the information promptly after it knows (or is reckless in not knowing) that the information selectively disclosed was both material and non-public.

In introducing Regulation FD, the SEC stated that:

> We believe that the practice of selective disclosure leads to a loss of investor confidence in the integrity of our capital markets. Investors who see a security's price change dramatically and only later are given access to the information responsible for that move rightly question whether they are on a level playing field with market insiders.[213]

The SEC has not sought to prescribe the means by which information is to be publicly disclosed.

There are indications that this Regulation FD has led to many US companies using open dial-in conferences, webcasts, or other forms

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[213] SEC Final Rule *Selective disclosure and insider trading* (2000).

of public briefings, to present information to analysts.[214] When private briefings are held, the usual practice is for a lawyer or other expert to be in attendance to advise the company on the disclosure of corporate information.

5.4.3 Canada

There is no specific legislation directed at private briefings, though they are subject to restrictions to ensure compliance with insider trading prohibitions. For instance, under the 'tipping' provisions of the insider trading prohibition, anyone in a 'special relationship' with a reporting issuer is prohibited from trading securities of the issuer with knowledge of non-public material information. In addition, persons in a special relationship with the issuer are prohibited from informing others of an undisclosed material fact or material change, other than in the necessary course of business, before such information has been generally disclosed.[215]

Also:

> Securities legislation does not provide a safe harbour which allows companies to correct an unintended selective disclosure of material information. If a company makes an unintended selective disclosure it should take immediate steps to ensure that a full public announcement is made. This includes contacting the relevant stock exchange and requesting that trading be halted pending the issuance of a news release. Pending the public release of the material information, the company should also tell those parties who have knowledge of the information that the information is material and that it has not been generally disclosed.[216]

In addition, *National Policy 51-201—Disclosure standards* (the policy statement) provides guidelines concerning private corporate briefings to analysts, institutional investors and other market professionals. The policy statement recognises that analysts can contribute to greater market efficiency by seeking, analysing and interpreting information and making recommendations. However:

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214 As summarised by G North, 'Closed and private company briefings: Justifiable or unfair?' (2008) 26 C&SLJ 501 at 510, 513–514.

215 OSA s 76(1), (2). For a more detailed outline of the tipping provisions, including how they apply to analysts, see *National Policy 51-201 Disclosure Standards* Sections 3.1–3.5 and 5.4.

216 *National Policy 51-201 Disclosure Standards*, Section 3.6.

> Companies should be sensitive though to the risks involved in private meetings with analysts. We are not suggesting that companies should stop having private briefings with analysts or that these private meetings are somehow illegal. Companies should have a firm policy of providing only non-material information and publicly disclosed information to analysts.[217]

The policy statement advises companies to limit the number of persons who are authorised to speak to analysts and others on the company's behalf:

> Everyone in your company should know who the company spokespersons are and refer all inquiries from analysts, investors and the media to them. Having a limited number of company spokespersons helps reduce the risk of (a) unauthorized disclosures (b) inconsistent statements by different persons in the company and (c) statements that are inconsistent with the public disclosure record of the company.[218]

The policy statement also recommends that companies:

> observe a quarterly quiet period [Canada has quarterly reporting], during which no earnings guidance or comments with respect to the current quarter's operations or expected results will be provided to analysts, investors or other market professionals. The quiet period should run between the end of the quarter and the release of a quarterly earnings announcement although, in practice, quiet periods vary by company. Companies need not stop all communications with analysts or investors during the quiet period. However, communication should be limited to responding to inquiries concerning publicly available or non-material information.

The policy statement considers that Canadian companies should use the following practices to avoid selective disclosure of material non-public information to analysts:[219]

> Companies should not disclose significant data, and in particular financial information such as sales and profit figures, to analysts, institutional investors and other market professionals selectively rather than to the market as a

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217 id, Section 5.1.
218 id, Section 6.5.
219 id, Section 5.1.

> whole. Earnings forecasts are in the same category. Even within these constraints there is plenty of scope to hold a useful dialogue with analysts and other interested parties about a company's prospects, business environment, management philosophy and long term strategy.
>
> Another way to avoid selective disclosure is to include, in the company's regular periodic disclosures, details about topics of interest to analysts. For example, companies should expand the scope of their interim management's discussion and analysis disclosure ("MD&A"). More comprehensive MD&A can have practical benefits including: greater analyst following; more accurate forecasts with fewer revisions; a narrower range between analysts' forecasts; and increased investor interest.
>
> A company cannot make material information immaterial simply by breaking the information into seemingly non-material pieces. At the same time, a company is not prohibited from disclosing non-material information to analysts, even if these pieces help the analyst complete a "mosaic" of information that, taken together, is material undisclosed information about the company.

The policy statement also raises concerns about requests from analysts for corporate officers to review corporate earning estimates being prepared by analysts:

> A company takes on a high degree of risk of violating securities legislation if it selectively confirms that an analyst's estimate is 'on target' or that an analyst's estimate is 'too high' or 'too low', whether directly or indirectly through implied 'guidance'.[220]

The policy statement confirms that confidentiality agreements with analysts or other market professionals cannot be relied upon as an exception to the tipping prohibition under the insider trading laws:

> if a company discloses material undisclosed information to an analyst, it has violated the [insider trading] prohibition, with or without a confidentiality agreement (unless the disclosure is made in the necessary course of business). Analysts who get an advance private briefing have an advantage. They have more time to prepare and can

[220] id, Section 5.2.

> therefore brief their firm members and clients sooner than those who did not have access to the information.[221]

The policy statement also recommends that analysts, institutional investors, investment dealers and other market professionals adopt internal review procedures to guard against and deal with the receipt of non-public material information. Such procedures are necessary because market professionals who receive material undisclosed information from a company are 'tippees' and cannot trade or further inform other persons about such information, other than in the necessary course of business.[222]

5.5 Benefits of briefings to analysts

Briefings to analysts have been described as a means of improving the pricing efficiency of financial markets in that:[223]

- they allow an exchange of information on management quality, research and development and innovation
- companies report the financial results publicly, but the private briefings focus on interpretation and explaining how and why the results were achieved
- as financial reports become more obscure, complex and technical, private meetings with analysts and institutions ensure that financial reports are properly understood and construed[224]
- analysts undertake ongoing intellectual analysis in the wake of private briefings, which in turn feeds into the efficient market pricing mechanism of companies

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[221] id, Section 5.3.

[222] id, Section 5.4.

[223] Some of these claimed benefits are referred to in G North, 'Closed and private company briefings: Justifiable or unfair?' (2008) 26 C&SLJ 501 at 508.

[224] G North, 'Closed and private company briefings: Justifiable or unfair?' (2008) 26 C&SLJ 501 at 508 cites a survey conducted in 1995 and 1996 of executives of 33 large listed UK companies by J Holland, 'Private voluntary disclosure, financial intermediation and market efficiency' (1998) 25 *Journal of Business Finance and Accounting* 29.

- the release of information to major market influencers through private briefings keeps the market informed through advisory or trading actions.

These briefings also provide an opportunity to analysts to assess the capacity of corporate officers to run the company in an efficient and effective manner.

Briefings have also been described as an important part of a company's investor relations program, allowing the company to articulate its:

- long-term strategy
- organization history, vision and goals
- management philosophy and the strength and depth of management
- competitive advantages and risks in the context of industry trends and issues
- key sources of profit.[225]

It is also argued that the flow of information to financial markets is enhanced when listed entities have a clear dialogue with investment professionals involved in the production of research:

> Open and professional communications facilitate a fair, orderly and transparent market, for the benefit of all participants. For analysts, this means they have reasonable access to the company information that they need to perform their job. For listed entities, this assists them in attracting or allocating capital more effectively. For investors, this helps to make informed investment decisions.[226]

Furthermore:

> Although much of the information about listed entities comes to investors from the issuers themselves, research

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225 Australasian Investor Relations Association, *Best Practice Investor Relations: Guidelines for Australasian Listed Entities* (May 2006) at 8.

226 AIRA and Finsia, *Principles for building better relations between listed entities and analysts*.

> reports prepared and distributed by financial analysts are equally crucial. In order to conduct high quality research and make recommendations that have reasonable and adequate bases, analysts must communicate directly with company representatives, especially investor relations officers and senior management. Only through such dialogue can analysts fully comprehend the information in a company's public disclosure documents (e.g. company annual reports).
>
> Because listed entities receive requests for information and access to company management from many people—individual shareholders, institutional investors, financial analysts, retail investors and the media—they cannot be expected to fulfill every request for direct access to specific individuals.
>
> However, listed entities should recognise the vital role that qualified financial analysts play in the financial market. Analysts must, from time to time, inevitably form opinions on the quality of management and this may involve an in-person analyst meeting. Such meetings are an opportunity to ask questions and obtain further details about results and plans already publicly released by the company. Importantly, this opportunity allows the analyst to assess and evaluate management's answers.[227]

5.6 Concerns about private briefings

Concerns have been raised about compliance and enforcement issues that may arise with private briefings, as well as some broader and more general questions of market fairness.

5.6.1 Insider trading and continuous disclosure

One concern is that private briefings may increase the practical likelihood of analysts receiving, and acting upon, inside information, notwithstanding the legislative prohibition on insider trading. Questions may also arise concerning compliance with the continuous disclosure requirements.

The industry guidance responds to these concerns, pointing out that briefings of analysts should be limited to an opportunity to provide background to previously disclosed information, not to discuss

227 ibid.

undisclosed price-sensitive information.[228] In the same vein, the ASX Corporate Governance Council Principles state that companies should promote timely and balanced disclosure of all material matters concerning the company.[229]

ASIC and the ASX, in their various documents, have recommended the following practical steps that companies can take to ensure that the release of information to analysts complies with the continuous disclosure requirements and does not breach the insider trading laws:

Overseeing, coordinating and monitoring disclosure

- companies should nominate a senior officer responsible for overseeing and coordinating disclosure of information to the stock exchange, analysts, brokers, shareholders, the media and the public.[230] Similarly, the Australasian Investor Relations Association (AIRA) envisages the appointment of an investor relations officer responsible for managing a listed entity's disclosure process in accordance with continuous disclosure principles and co-ordinating production and dissemination of material information to the market.[231] AIRA also sees one of the investor relations objectives as being to build working relationships with analysts (as well as with portfolio managers, investor relations industry associations, regulators, senior managers within the organization, communities and financial media)

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228 Australasian Investor Relations Association, *Best Practice Investor Relations: Guidelines for Australasian Listed Entities* (May 2006) at 8. AIRA states that any material information inadvertently disclosed during these briefings should be immediately released to the exchanges(s) on which the issuer is listed and the information made readily available to all investors.

229 *Corporate Governance Principles and Recommendations* (2nd edition, 2007), Principle 5.

230 *Better Disclosure for Investors* Principle 3. See also ASX Corporate Governance Council *Corporate Governance Principles and Recommendations* (2nd edition, 2007), Box 5.1.

231 *Best Practice Investor Relations: Guidelines for Australasian Listed Entities* (May 2006) at 6.

- this officer should be aware of information disclosures in advance, including information to be presented at private briefings[232]

Releasing company information

- price-sensitive information must be publicly released through the stock exchange before disclosing it to analysts or others outside the company. Further dissemination to investors (for instance, on the company's website immediately after the stock exchange confirms an announcement has been made[233]) is desirable following release through the stock exchange[234]

Briefing analysts

- *reviewing discussions:* companies should have a procedure for reviewing briefings and discussions with analysts afterwards to check whether any price-sensitive information has been inadvertently disclosed. If it has, the company should announce the information immediately through the stock exchange, then post it on the company website (as the company no longer has control of that information). Slides and presentations used in briefings should be given to the stock exchange for immediate release to the market and posted on the company website[235]

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232 *Better Disclosure for Investors*, Principle 5. The ASX Commentary on this principle in Guidance Note 8 states (at para 87) that the 'relevant officer should either be involved with the day to day management of the entity and have a high degree of familiarity across the breadth of its operations, or have ready access to senior management who have responsibility for day to day management of the entity. This will assist to ensure that the officer is kept informed of any planned disclosures, including activities such as analysts' briefings and press conferences'.

233 *Better Disclosure for Investors—Guidance Rules* (2000) Principle 2 is that companies should use current technology to give investors better access to corporate information. In particular, price-sensitive information should be posted on a company's website as soon as it is disclosed to the market. The ASX says that, as minimum best practice, companies should place analysts' briefings on the company's website or retain a third party to do so: Guidance Note 8 para 82, Commentary on Principle 2 in *Better Disclosure for Investors—Guidance Rules*.

234 *Better Disclosure for Investors* Principle 6, commented on in ASX Guidance Note 8 para 88. See also *Heard it on the grapevine* paras 29–32, ASX Guidance Note 8 paras 59–62. Companies may find it useful to consider briefings of analysts when formulating their continuous disclosure policies: *Corporate Governance Principles and Recommendations* (2nd edition, 2007) Box 5.1.

235 *Better Disclosure for Investors* Principle 8. See also ASX Guidance Note 8 para 90.

- *handling unanticipated questions:* when dealing with analysts' questions that raise issues outside the intended scope of discussion:

  – only information that has been publicly released through the stock exchange should be discussed.[236] A company may be able to answer an analyst's question in general terms (for instance, by confirming the fact of a bid in a tendering process which is publicly known) while not giving detailed disclosure (for instance, the details of the bid or the tender process)[237]

  – if a question can only be answered by disclosing price-sensitive information, the company representative should decline to answer or take the question on notice and announce the information through the stock exchange before responding[238]

- *responding on financial projections and reports*: companies should:

  – confine comments on market analysts' financial projections to errors in factual information and underlying assumptions (it is inappropriate to correct a draft report if doing so involves providing material information that is not public: any clarification should be confined to drawing the analyst's attention to information that has already been made available to the market[239])

  – seek to avoid any response that may suggest that the company's, or the market's, current projections are incorrect

  – use the continuous disclosure regime to establish a range within which earnings are likely to fall

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236 *Better Disclosure for Investors* Principle 9, *Heard it on the grapevine* paras 49–50, ASX Guidance Note 8 para 59.
237 ASX Guidance Note 8 para 92.
238 *Better Disclosure for Investors* Principle 9, *Heard it on the grapevine* paras 49–50.
239 ASX Guidance Note 8 paras 59–60.

– publicly announce any change in expectations before commenting to anyone outside the company.[240]

The Australasian Investor Relations Association provides further guidance on how to avoid breaches of the insider trading law or a company's continuous disclosure obligations in relation to briefings to analysts:

> Any new material information delivered during these briefings should be lodged with the exchange(s) on which the issuer is listed prior to it being provided to investors/analysts.
>
> Some listed entities impose 'blackout periods' during which they do not make appointments with institutions/analysts. The blackout usually commences at, or soon after, the end of the financial period and concludes when a listed entity's results are announced.
>
> Whether or not a company imposes blackout periods, it is important for listed entities to avoid giving any indication of what their results may be before this information has been lodged with the exchange(s) on which the issuer is listed, and adhere to continuous disclosure obligations.[241]

AIRA also recommends that companies develop policies on:

- avoiding discussion of unreleased price-sensitive information in briefings of analysts
- how to handle questions in relation to price-sensitive information
- how to respond in the event of an inadvertent release of price-sensitive information during market briefings.[242]

5.6.2 Record-keeping

There is no obligation on companies to record communications at private briefings. In the event of an enforcement action for, say,

240 Principle 10. See also ASX Guidance Note 8 paras 93–95.

241 Australasian Investor Relations Association, *Best Practice Investor Relations: Guidelines for Australasian Listed Entities* (May 2006) at 9.

242 Australasian Investor Relations Association, *Best Practice Investor Relations: Guidelines for Australasian Listed Entities* (May 2006) at 17.

insider trading, the onus remains on the regulator to prove that material price-sensitive and confidential information was provided to analysts.

AIRA recommends that listed entities:

- keep a record of all meetings and briefings with investors/analysts[243]
- consider making recordings or transcripts from conference calls available on request and/or add these to the organization's website.[244]

A record could assist in any investigation of the insider trading or continuous disclosure provisions.

5.6.3 Fairness

Private briefings of analysts, even when carefully conducted to ensure that there is no breach of the insider trading or continuous disclosure provisions, may nevertheless still raise questions of fairness and equal access to corporate information.

There may be a perception that significant information not available to investors generally (for instance, a better appreciation of company strategies, opportunities and future prospects) is being disclosed at private briefings, or that analysts present can, through questions, gain a fuller or earlier understanding of publicly released information than the market generally.[245] Private briefings could also be seen as giving analysts who have better contacts in listed companies an unfair advantage over their uninvited counterparts.[246]

Some attempt has been made to determine whether private briefings confer on those attending them significant benefits not available to other analysts or investors generally. For instance, one study has suggested that:

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243 At 8.

244 Australasian Investor Relations Association, *Best Practice Investor Relations: Guidelines for Australasian Listed Entities* (May 2006) at 9.

245 *Heard it on the grapevine* para 2.

246 *Heard it on the grapevine* para 21.

- companies manage private meetings around the public result announcements to be able to claim that they are saying the same thing in private and public, though in practice the information content of the published material is much less than the private exchange

- the quality of private disclosure is much higher than that of public disclosure because the private discussion is much richer conceptually: public voluntary disclosure is designed merely to satisfy minimum market pressures and regulations

- private meetings draw the attention of financial institutions or analysts to the key parts of complex published documents.[247]

A survey conducted in 1999 indicated that analysts rated private contact with companies, including private analysts' meetings, as a more important primary source of information than reliance on public documents.[248]

Concerns have been expressed about the absence of a requirement for prior public notice of the timing of the release of a company's financial results. It is suggested that some analysts or other market participants, but not the market generally, receive advance notice of the timing of this publication and accompanying presentations.

5.7 Matters for consideration

The Issues Paper raised for consideration a series of questions concerning public and private corporate briefings to analysts and whether further initiatives were necessary.

A summary of responses in submissions is set out below.

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247 J Holland, 'Private voluntary disclosure, financial intermediation and market efficiency' (1998) 25 *Journal of Business Finance and Accounting* 29, cited by G North, 'Closed and private company briefings: Justifiable or unfair?' (2008) 26 C&SLJ 501 at 509.

248 M Epstein & K Palepu, 'What financial analysts want' (1999) 80 Strategic Finance 48, cited by G North, 'Closed and private company briefings: Justifiable or unfair?' (2008) 26 C&SLJ 501 at 509.

5.7.1 Role of briefings

The general view in submissions was that private, as well as public, briefings are an important and necessary element of a well-functioning market, provided the law is complied with.

Respondents considered that briefings of analysts promote market efficiency by:

- increasing the dissemination of accurate information on companies to the market
- helping ongoing price formation in the market
- enabling management to explain a company's financial results, business strategies and outlook
- enabling analysts to question and evaluate management and formulate more knowledgeable recommendations.

5.7.2 Open briefings

Submissions generally did not consider that the process of open briefings required further legislative prescription or direction. Also, reasons given for opposing legislative specification of how to make information presented at these briefings generally available to the market included:

- companies can best determine the most effective and efficient disclosure mechanism for their particular circumstances
- current arrangements are more flexible than prescriptive obligations and burdensome requirements might hinder the timeliness and extent of information flow in the market
- a more flexible approach allows companies to take advantage of technological developments.

Some respondents suggested that companies should be encouraged to announce the timing of public briefings to analysts in advance and to webcast or podcast these briefings, but this method of dissemination of information should not be mandated. One suggestion was that the ASX Corporate Governance Council *Principles and Recommendations* could include a recommendation to this effect.

5.7.3 Private briefings

The predominant view in submissions was that private briefings:

- are a valuable way to be accurately informed about, or properly understand, information regarding the issuer that is already in the public domain

- enable analysts and other professionals to clarify points and ask corporate officers about information that is already in the public domain. For instance, they can be a vital part of ensuring accurate external valuations of companies.

It was also argued that any move to ban private briefings would reduce the amount and quality of informed opinion about companies available to security holders and investors generally and have a negative effect on the market. For instance, a requirement that all briefings be public may inhibit market efficiency by enabling persons accessing the briefing to 'free ride' observations or lines of inquiry raised by particular analysts on publicly available information concerning a company, thereby discouraging analysts from engaging in probing analysis and broking firms from supporting a research arm.

A possible qualification by one respondent was that, while private briefings may contribute to efficient market pricing, issues of fairness and integrity, both real and perceived, raise questions about the net benefit of these briefings.

There was no support for introducing the equivalent of SEC Regulation FD, given that the mischief at which it is directed, namely the gap in the application of the US insider trading laws to analysts, does not arise with the Australian insider trading provisions.

The predominant view in submissions was that the current regulatory framework (including the industry best practice guides) suffices, though some respondents favoured some initiative in the area of record-keeping of private briefings. It was suggested in some submissions that the ASX Corporate Governance Council could develop best practice guidelines on companies keeping a record of private briefings setting out 'who, when, and where' and an outline of the topics discussed. Another possibility raised in submissions was a legislative obligation of this nature, both to assist the regulatory enforcement process and to maintain confidence in the integrity of the market. Opponents of a mandatory record-keeping requirement pointed to the difficulties of ensuring the accuracy of these records (short of mandatory recording of conversations) and the administrative burden in preparing them.

The Issues Paper raised the question 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. In this regard, submissions did not support an outright prohibition during particular periods, arguing that there can be valid reasons for briefing market analysts, even during blackout periods. Companies are in the best position to determine this, provided they comply with applicable disclosure requirements. However, some submissions favoured the ASX Corporate Governance Council including a best practice recommendation that companies not conduct private briefings during a blackout period.

Some submissions supported requiring or encouraging a listed company to inform the market in advance of when it will publish its financial results.

5.8 Advisory Committee position

The practice by which listed companies provide briefings from time to time to analysts, institutional investors and others on their business and performance provides a useful and probably necessary supplement to their formal disclosures to the market through their annual and other reporting and in their continuous disclosures.

The opportunity for analysts who follow a company to hear from, and question, senior management and seek clarification of particular points, by better informing their understanding and their analysis, recommendations and investment decisions, can enhance the flow of information to the market and contribute to market efficiency.

Presentations and responses to questions can clarify the information provided in the financial and other reports to the market by a company. Face-to-face presentations by senior management also provide a valuable opportunity for assessing the quality of key members of a management team and their knowledge of the business.

At the same time, there are risks involved. Lack of discipline in briefing practices can lead to selective disclosure of market-sensitive information and fuel perceptions of favoured treatment of particular individuals, firms or groups and thereby harm investor confidence. It should be noted that analysts or others who are provided with market-sensitive information in the course of a briefing will be compromised in terms of their ability to use that information without themselves breaching the insider trading laws.

The relevant legal framework includes the insider trading provisions, which constrain the information a company can provide in a briefing, or the use that analysts can make of it, unless the information is already, or also is made, generally available to the market. It is an offence for anyone with inside information to trade in affected securities or communicate the information to any other party who is likely to trade in those securities.

The continuous and other disclosure requirements on a company are also relevant. To the extent that the market is kept properly informed by a company, there is less risk of improper disclosures in the course of communications with analysts or other third parties.

The Committee does not see a need for further legislative intervention. While the US approach, reflected in Regulation FD, seems to have had a positive effect in encouraging greater use of open briefings, there is not the need for such legislation in Australia, given that Australian insider trading provisions already apply to the communication of inside information to third parties, such as analysts, who do not owe a duty to the company.

The management by a listed company of its briefing of analysts, together with other corporate communications, is, however, a core aspect of good governance. The Committee sees scope for further promotion of best practice in this area.

It is in the interests of a well-run company, as part of an effective communication strategy, to control its communications with analysts and others concerning its business and affairs. An appropriate policy would clarify responsibilities for speaking and presenting information on behalf of the company and aim for consistency and accuracy in communication as well as compliance with legal requirements.

This is an area where action by the ASX Corporate Governance Council to build on existing regulatory and industry guidance, and overseas models, would be worthwhile. It is suggested that the *Principles and Recommendations* should provide guidance for companies, including that they:

- have processes to control who is authorised to speak on their behalf
- where possible, particularly in the case of profit announcements, arrange for advance notification of briefings and make them open and accessible, including through use of the Internet
- reinforce the need for briefings or other communications with analysts and other third parties to avoid disclosure of market-sensitive information that is not generally available to the market
- establish processes for checking the information disclosed at briefings and, in the event of inadvertent disclosure of confidential price-sensitive information, make that information generally available to the market
- keep a record of briefings and matters addressed, including those present and the time, place and subject matter of the meeting
- introduce appropriate restraints on the kinds of communications that can occur during periods prior to the release of financial results or at other times of market sensitivity.

The carrying out of such an approach, while not unduly restricting the flow of information to the market, should help reduce the possibility of inadvertent selective disclosure of confidential price-sensitive information and maintain investor confidence in the integrity of the market.

Appendix A Letter from the Minister

19 November 2008

Mr Richard St John
Convenor
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr St John

As a result of the global financial crisis and the related turbulence in Australian financial markets, the effect on the market of a number of practices has given rise to a significant degree of concern in the business, and broader, community.

I am concerned that the lack of transparency and accountability surrounding some of these practices could mean that there is potential for damage to the integrity of the market and investor confidence. In my view, the Corporations and Markets Advisory Committee, as a statutory source of independent advice to the Australian Government on issues relating to corporations and financial markets law and practice, is the correct forum to provide advice on the effect of these practices.

Directors' interests in listed securities and margin lending

Margin lending refers to the practice of providing loans that are secured over an asset held by the borrower, with a condition that if the ratio of the asset's market value to the amount of the loan falls below an agreed level, the borrower may become subject to a 'margin call'. If this occurs the borrower must reduce the level of indebtedness or increase the value of the security pledged, commonly by selling part of the security to pay down the loan. Margin loans are commonly utilised to enable investors to acquire financial products, which are then used as the collateral.

Margin lending plays an important role in the market. It facilitates investors' access to finance and their ability to pledge assets as security. Any restriction on margin lending has the potential to distort investment decisions and interfere with the efficient allocation of capital.

Margin lending can provide a means of facilitating the acquisition of meaningful shareholdings by directors, which may contribute to the alignment of directors' and companies' interests and act as an inducement to good performance. The leveraging of shareholdings may magnify a director's gain or loss from those shareholdings.

However, following financial market events in early 2008, some analysts have suggested that there may be a significant adverse impact on the market price of a company's shares where a director is required to divest large parcels of shares as a result of a margin call. In particular, concerns have been directed at the level of disclosure to the market of margin lending arrangements.

Regulation of margin lending

ASX listing rule 3.1 provides that, once a company becomes aware of information concerning it that a reasonable person would expect to have a material effect on the value of the company's securities, the entity must immediately inform the ASX.

On 29 February 2008, the ASX and ASIC jointly issued *Companies Update 02/08* which clarified that, where a director's relevant and material shareholding is subject to a margin loan (or similar funding arrangement), listing rule 3.1 may, in 'appropriate circumstances', require an entity to disclose the key terms of the arrangements (including the number of securities involved, the trigger points, the rights of the lender to sell unilaterally, and any other material details). This disclosure obligation operates in conjunction with section 191 of the *Corporations Act 2001*, which arguably obliges a director to disclose their substantial shareholdings that are subject to loan arrangements. This provision obliges a director with a material personal interest in a matter relating to the affairs of the company to give the other directors notice of that interest.

Notwithstanding the companies update required under ASX listing rule 3.1 and section 191, some uncertainty may remain as to the nature of directors' obligations to disclose margin loan arrangements to their boards, and the obligations of companies to disclose margin loan arrangements to the market.

There is also a question as to whether the current disclosure obligations in respect of margin lending arrangements best address the various competing policy considerations involved.

Better disclosure to the market will improve the ability of market participants to assess the risk of divestiture of material shareholdings by directors. However, some commentators have suggested that the provision of specific details of loan arrangements, such as trigger prices, may encourage market manipulation by short sellers of the company's stock.

The frequency, nature and extent of any mandatory disclosures may also impact on the regulatory burden imposed on companies. Generally, greater disclosure increases the costs and complexity of compliance. Improving the clarity and certainty of the test to be applied in determining whether disclosure is required may reduce complexity, the costs of compliance, and costs resulting from erroneous non-compliance.

The current regime should also be assessed in terms of the effect on directors as well as on the company itself. Rules that impose costs upon directors may act as a disincentive to directors acquiring a material shareholding in companies that employ them. The extent to which any rules require the disclosure of the personal affairs of directors or their associates may have a similar effect.

In regards to this issue, I refer you to the work previously undertaken by Chartered Secretaries Australia (*Disclosure of shareholdings subject to security interest or other third-party rights—submission to ASX*, 13 June 2008) and the Australian Institute of Company Directors (*Position paper no. 9—Directors' Margin Loans*, 21 July 2008).

Having regard to all the above matters, I request that CAMAC:

(i) examine how overseas jurisdictions regulate the disclosure of directors' shareholdings subject to margin loans or similar funding arrangements, and compare and contrast overseas regulation with that of Australia; and

(ii) advise whether changes are required to Australia's regulatory framework and if so what form they should take.

'Blackout' trading by company directors

A 'blackout' period refers to the time when a company's officers are prohibited by the policies set by the company from trading in the company's securities. These periods generally occur prior to the release of annual or half-yearly results. 'Blackout' trading is when officers trade during a 'blackout' period.

The obligation to have a 'blackout' policy is regulated by Recommendation 3.2 of the ASX Corporate Governance Council *Principles and Recommendations*. This states 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'. Under ASX Listing Rule 4.10.3, a company is required to provide a statement in its annual report disclosing the extent to which it has followed the *Principles and Recommendations*. If the company has not followed a recommendation, it must provide reasons for its non-compliance.

'Blackout' trading is not against the law, however, individuals who trade with information which is not generally available are subject to the insider trading prohibitions in Part 7.10 of the Corporations Act. Additionally, section 183 of the Corporations Act imposes a prohibition on directors improperly using company information to gain a personal advantage, and section 205G of the Corporations Act and ASX listing rule 3.19A impose disclosure obligations in respect of the holding, or alteration, by directors of certain interests they have in the company.

Both the ASX and Regnan have recently reviewed trading by directors and found a significant lack of compliance with regard to not trading in the 'blackout' period. ASX Markets Supervision Pty Limited (ASXMS) also conducted a review which examined rule 3.19A notifications via the Companies Announcements Platform between 1 January 2008 and 31 March 2008. That review found that of the 1,863 active trade notifications lodged, 43 per cent occurred in the period between the close of books and the release to the market of the relevant entity's half-year and full-year results. Both reviews also identified significant levels of late compliance or non-compliance by directors with their obligations under section 205G and rule 3.19A.

I note that ASIC published Regulatory Guide 193—*Notifications of directors' interests in securities—listed companies* on 25 June 2008. This document provides some clarification of the notification obligations of directors and sets out the criteria taken into account by ASIC when assessing whether regulatory action should be taken.

I am concerned that active trading by directors between the close of books and the release of results has the potential to affect confidence in the integrity of Australia's markets. From a policy perspective, such confidence is central to maintaining Australia's attractiveness as an investment destination.

I request that CAMAC:

(i) examine how overseas jurisdictions regulate 'blackout' trading, and compare and contrast overseas regulation with that of Australia;

(ii) while noting the already extensive insider trading prohibition, advise whether changes are required to Australia's regulatory framework to provide for greater confidence in the integrity of the market, specifically relating to directors' trading activity; and

(iii) advise what form any such changes should take if they are required.

Spreading false or misleading information

During the recent market turbulence, concerns have been raised that some market participants may have been spreading false or misleading information in respect of certain securities in order to take advantage of artificial changes in their price. This practice is sometimes referred to as 'rumourtrage'.

Section 1041E of the Corporations Act prohibits the dissemination of false information that is likely to have a negative effect on the price of any securities in circumstances where the disseminator knew, or ought reasonably to have known, the information was false.

In parallel to this provision, there are prohibitions on market manipulation (section 1041A), false trading and market rigging (section 1041B and 1041C), and inducing a person to deal in a financial product using false or misleading information (section 1041F). Additionally, section 1041G of the Corporations Act prohibits a person carrying on a financial services business from engaging in dishonest conduct in relation to a financial product or financial service.

On 7 March 2008, the Australian Securities and Investments Commission initiated an investigation into the allegations of market manipulation by false rumours and collusive behaviour (Project Mint).In light of the concerns that have been raised regarding rumourtrage, it is appropriate to review the regulatory regime governing market manipulation, with specific focus on the spreading of false information.

I request that CAMAC:

(i) examine how overseas jurisdictions regulate the spread of false or misleading information, and compare and contrast overseas regulation with that of Australia; and

(ii) advise whether changes are required to Australia's regulatory framework, and if so what form they should take.

Disclosure of market-sensitive information

Analysts, and the research they perform, play an important role in Australia's financial markets, by keeping the market informed. Briefings are sometimes provided by companies to analysts on a private basis to assist in the pricing of securities in the market and to assist with research.

Under the continuous disclosure obligations in the Corporations Act and the ASX Listing Rules, price-sensitive information must be provided to the market once the company becomes aware of it. Continuous disclosure both ensures that the market is fully informed and contributes to market fairness and efficiency. Alternative ways in which market-sensitive information may be distributed include press briefings and posting information on the company's website.

There are concerns, however, that private briefings are being provided to analysts which create the perception that some analysts have access to critical information that is not available to other analysts, shareholders and the general public. These perceptions can lead to a lack of confidence in the integrity of Australia's financial markets and potentially create opportunities for insider trading.

I request that CAMAC:

(i) examine the role that analysts' briefings play in Australia's financial market, including whether their role is a positive one that leads to greater market efficiency; and

(ii) advise whether changes may be required to Australia's regulatory framework; and if so, what form they should take.

Referral and resourcing

It is important to ensure that Australia's system of corporate law and regulation is sufficiently robust to provide investors with confidence that they are able to make fully informed decisions. I therefore seek CAMAC's advice on the corporate law aspects of the matters set out in this letter.

In order to assist in this task, I have approved the payment of $100,000 to CAMAC. I would appreciate CAMAC's advice by 30 June 2009. Due to the nature of the issues contained in this referral, I believe it is important that this timeframe is adhered to, although I also note the complexity of these matters and as such I request that CAMAC keep Treasury informed of any factors that might impact on the delivery of your advice within this timeframe.

The Government values the expertise and insights that CAMAC brings to corporate law policy development and looks forward to receiving its report.

Yours sincerely

NICK SHERRY

Appendix B The FSA Model Code

Introduction

The FSA Model Code imposes restrictions on dealing in the securities of a listed company beyond those imposed by law. Its purpose is to ensure that persons discharging managerial responsibilities do not abuse, and do not place themselves under suspicion of abusing, inside information that they may be thought to have, especially in periods leading up to an announcement of the company's results.

Nothing in the Model Code sanctions a breach of the market abuse or insider trading provisions or any other relevant legal or regulatory requirements.

The Code provides as follows:

Definitions

1 In this code the following definitions, in addition to those contained in the listing rules, apply unless the context requires otherwise:

(a) close period means:

(i) the period of 60 days immediately preceding a preliminary announcement of the listed company's annual results or, if shorter, the period from the end of the relevant financial year up to and including the time of announcement; or

(ii) the period of 60 days immediately preceding the publication of its annual financial report or if shorter the period from the end of the relevant financial year up to and including the time of such publication; and

(iii) if the listed company reports on a half yearly basis the period from the end of the relevant financial period up to and including the time of such publication; and

(iv) if the listed company reports on a quarterly basis the period of 30 days immediately preceding the announcement of the quarterly results or, if shorter, the period from the end of the relevant financial period up to and including the time of the announcement;

(b) connected person has the meaning given in section 96B(2) of the Act (Persons discharging managerial responsibilities and connected persons);

(c) dealing includes:

(i) any acquisition or disposal of, or agreement to acquire or dispose of any of the securities of the company;

(ii) entering into a contract (including a contract for difference) the purpose of which is to secure a profit or avoid a loss by reference to fluctuations in the price of any of the securities of the company;

(iii) the grant, acceptance, acquisition, disposal, exercise or discharge of any option (whether for the call, or put or both) to acquire or dispose of any of the securities of the company;

(iv) entering into, or terminating, assigning or novating any stock lending agreement in respect of the securities of the company;

(v) using as security, or otherwise granting a charge, lien or other encumbrance over the securities of the company;

(vi) any transaction, including a transfer for nil consideration, or the exercise of any power or discretion effecting a change of ownership of a beneficial interest in the securities of the company; or

(vii) any other right or obligation, present or future, conditional or unconditional, to acquire or dispose of any securities of the company;

(d) [deleted]

(e) prohibited period means:

(i) any close period; or

(ii) any period when there exists any matter which constitutes inside information in relation to the company;

(f) restricted person means a person discharging managerial responsibilities; and

(g) securities of the company means any publicly traded or quoted securities of the company or any member of its group or any securities that are convertible into such securities.

Dealings not subject to the provisions of this code

2 The following dealings are not subject to the provisions of this code:

(a) undertakings or elections to take up entitlements under a rights issue or other offer (including an offer of securities of the company in lieu of a cash dividend);

(b) the take up of entitlements under a rights issue or other offer (including an offer of securities of the company in lieu of a cash dividend);

(c) allowing entitlements to lapse under a rights issue or other offer (including an offer of securities of the company in lieu of a cash dividend);

(d) the sale of sufficient entitlements nil-paid to take up the balance of the entitlements under a rights issue;

(e) undertakings to accept, or the acceptance of, a takeover offer;

(f) dealing where the beneficial interest in the relevant security of the company does not change;

(g) transactions conducted between a person discharging managerial responsibilities and their spouse, civil partner, child or step-child (within the meaning of section 96B(2) of the Act);

(h) transfers of shares arising out of the operation of an employees' share scheme into a savings scheme investing in securities of the company following:

  (i) exercise of an option under an approved SAYE option scheme; or

  (ii) release of shares from a HM Revenue and Customs approved share incentive plan;

(i) with the exception of a disposal of securities of the company received by a restricted person as a participant, dealings in connection with the following employees' share schemes;

  (i) an HM Revenue and Customs approved SAYE option scheme or share incentive plan, under which participation is extended on similar terms to all or most employees of the participating companies in that scheme; or

  (ii) a scheme on similar terms to a HM Revenue and Customs approved SAYE option scheme or share incentive plan, under which participation is extended on similar terms to all or most employees of the participating companies in that scheme; or

(j) the cancellation or surrender of an option under an employees' share scheme;

(k) transfers of the securities of the company by an independent trustee of an employees' share scheme to a beneficiary who is not a restricted person;

(l) transfers of securities of the company already held by means of a matched sale and purchase into a saving scheme or into a pension scheme in which the restricted person is a participant or beneficiary;

(m) an investment by a restricted person in a scheme or arrangement where the assets of the scheme (other than a scheme investing only in the securities of the company) or arrangement are invested at the discretion of a third party;

(n) a dealing by a restricted person in the units of an authorised unit trust or in shares in an open-ended investment company; and

(o) bona fide gifts to a restricted person by a third party.

Dealing by restricted persons

3 A restricted person must not deal in any securities of the company without obtaining clearance to deal in advance in accordance with paragraph 4 of this code.

Clearance to deal

4 (a) A director (other than the chairman or chief executive) or company secretary must not deal in any securities of the company without first notifying the chairman (or a director designated by the board for this purpose) and receiving clearance to deal from him.

(b) The chairman must not deal in any securities of the company without first notifying the chief executive and receiving clearance to deal from him or, if the chief executive is not present, without first notifying the senior independent director, or a committee of the board or other officer of the company nominated for that purpose by the chief executive, and receiving clearance to deal from that director, committee or officer.

(c) The chief executive must not deal in any securities of the company without first notifying the chairman and receiving clearance to deal from him or, if the chairman is not present, without first notifying the senior independent director, or a committee of the board or other officer of the company nominated for that purpose by the chairman, and receiving clearance to deal from that director, committee or officer.

(d) If the role of chairman and chief executive are combined, that person must not deal in any securities of the company without first notifying the board and receiving clearance to deal from the board.

(e) Persons discharging managerial responsibilities (who are not directors) must not deal in any securities of the company without first notifying the company secretary or a designated director and receiving clearance to deal from him.

Persons discharging managerial responsibilities are:

(in accordance with section 96B(1) of the Act):

(a) a director of an issuer:

(i) registered in the United Kingdom that has requested or approved admission of its shares to trading on a regulated market; or

(ii) not registered in the United Kingdom or any other EEA State but has requested or approved admission of its shares to trading on a regulated market and who is required to file annual information in relation to shares in the United Kingdom in accordance with Article 10 of the Prospectus Directive; or

(b) a senior executive of such an issuer who:

(i) has regular access to inside information relating, directly or indirectly, to the issuer; and

(ii) has power to make managerial decisions affecting the future development and business prospects of the issuer.

5 A response to a request for clearance to deal must be given to the relevant restricted person within five business days of the request being made.

6 The company must maintain a record of the response to any dealing request made by a restricted person and of any clearance given. A copy of the response and clearance (if any) must be given to the restricted person concerned.

7 A restricted person who is given clearance to deal in accordance with paragraph 4 must deal as soon as possible and in any event within two business days of clearance being received.

Circumstances for refusal

8 A restricted person must not be given clearance to deal in any securities of the company:

(a) during a prohibited period; or

(b) on considerations of a short term nature. An investment with a maturity of one year or less will always be considered to be of a short term nature.

Dealings permitted during a prohibited period

Dealing in exceptional circumstances

9 A restricted person, who is not in possession of inside information in relation to the company, may be given clearance to deal if he is in severe financial difficulty or there are other exceptional circumstances. Clearance may be given for such a person to sell (but not purchase) securities of the company when he would otherwise be prohibited by this code from doing so. The determination of whether the person in question is in severe financial difficulty or whether there are other exceptional circumstances can only be made by the director designated for this purpose.

10 A person may be in severe financial difficulty if he has a pressing financial commitment that cannot be satisfied otherwise than by selling the relevant securities of the company. A liability of such a person to pay tax would not normally constitute severe financial difficulty unless the person has no other means of satisfying the liability. A circumstance will be considered exceptional if the person in question is required by a court order to transfer or sell the securities of the company or there is some other overriding legal requirement for him to do so.

11 The FSA should be consulted at an early stage regarding any application by a restricted person to deal in exceptional circumstances.

Awards of securities and options

12 The grant of options by the board of directors under an employees' share scheme to individuals who are not restricted persons may be permitted during a prohibited period if such grant could not reasonably be made at another time and failure to make the grant would be likely to indicate that the company was in a prohibited period.

13 The award by the company of securities, the grant of options and the grant of rights (or other interests) to acquire securities of the company to restricted persons is permitted in a prohibited period if:

(a) the award or grant is made under the terms of an employees' share scheme and the scheme was not introduced or amended during the relevant prohibited period; and

(b) either:

(i) the terms of such employees' share scheme set out the timing of the award or grant and such terms have either previously been approved by shareholders or summarised or described in a document sent to shareholders, or

(ii) the timing of the award or grant is in accordance with the timing of previous awards or grants under the scheme; and

(c) the terms of the employees' share scheme set out the amount or value of the award or grant or the basis on which the amount or value of the award or grant is calculated and do not allow the exercise of discretion; and

(d) the failure to make the award or grant would be likely to indicate that the company is in a prohibited period.

Exercise of options

14 Where a company has been in an exceptionally long prohibited period or the company has had a number of consecutive prohibited periods, clearance may be given to allow the exercise of an option or right under an employees' share scheme, or the conversion of a convertible security, where the final date for the exercise of such option or right, or conversion of such security, falls during a prohibited period and the restricted person could not reasonably have been expected to exercise it at a time when he was free to deal.

15 Where the exercise or conversion is permitted pursuant to paragraph 14, clearance may not be given for the sale of the securities of the company acquired pursuant to such exercise or conversion including the sale of sufficient securities of the company to fund the costs of the exercise or conversion and/or any tax liability arising from the exercise or conversion unless a binding undertaking to do so was entered into when the company was not in a prohibited period.

Qualification shares

16 Clearance may be given to allow a director to acquire qualification shares where, under the company's constitution, the final date for acquiring such shares falls during a prohibited period and the director could not reasonably have been expected to acquire those shares at another time.

Saving schemes

17 A restricted person may enter into a scheme under which only the securities of the company are purchased pursuant to a regular standing order or direct debit or by regular deduction from the person's salary, or where such securities are acquired by way of a standing election to re-invest dividends or other distributions received, or are acquired as part payment of the person's remuneration without regard to the provisions of this code, if the following provisions are complied with:

(a) the restricted person does not enter into the scheme during a prohibited period, unless the scheme involves the part payment of remuneration in the form of securities of the company and is entered into upon the commencement of the person's employment or in the case of a non-executive director his appointment to the board;

(b) the restricted person does not carry out the purchase of the securities of the company under the scheme during a prohibited period, unless the restricted person entered into the scheme at a time when the company was not in a prohibited period and that person is irrevocably bound under the terms of the scheme to carry out a purchase of securities of the company (which may include the first purchase under the scheme) at a fixed point in time which falls in a prohibited period;

(c) the restricted person does not cancel or vary the terms of his participation, or carry out sales of securities of the company within the scheme during a prohibited period; and

(d) before entering into the scheme, cancelling the scheme or varying the terms of his participation or carrying out sales of the securities of the company within the scheme, the restricted person obtains clearance in accordance with paragraph 4.

Acting as a trustee

18 Where a restricted person is acting as a trustee, dealing in the securities of the company by that trust is permitted during a prohibited period where:

(a) the restricted person is not a beneficiary of the trust; and

(b) the decision to deal is taken by the other trustees or by investment managers on behalf of the trustees independently of the restricted person.

19 The other trustees or investment managers acting on behalf of the trustees can be assumed to have acted independently where the decision to deal:

(a) was taken without consultation with, or other involvement of, the restricted person; or

(b) was delegated to a committee of which the restricted person is not a member.

Dealing by connected persons and investment managers

20 A person discharging managerial responsibilities must take reasonable steps to prevent any dealings by or on behalf of any connected person of his in any securities of the company on considerations of a short term nature.

21 A person discharging managerial responsibilities must seek to prohibit any dealings in the securities of the company during a close period:

(a) by or on behalf of any connected person of his; or

(b) by an investment manager on his behalf or on behalf of any person connected with him where either he or any person connected has funds under management with that investment fund manager, whether or not discretionary (save as provided by paragraphs 17 and 18).

22 A person discharging managerial responsibilities must advise all of his connected persons and investment managers acting on his behalf:

(a) of the name of the listed company within which he is a person discharging managerial responsibilities;

(b) of the close periods during which they cannot deal in the securities of the company; and

(c) that they must advise the listed company immediately after they have dealt in securities of the company.