Submission to the Corporations and Markets Advisory Committee

Aspects of Market Integrity

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General Observations:

The Issues Paper, *Aspects of Market Integrity*, deals with issues raised by the Minister for Superannuation and Corporate Law.

The observations of Adams and Nehme can be summarised in the following manner:

- In relation to margin loans to directors, we support a self regulatory model;
- The ASX Corporate Governance Council should provide further guidance to companies about their approach to blackout trading;
- Rumour-mongering is a destructive force within the securities markets akin to market manipulation; and
- Public and private briefings are of great importance to ensure the integrity of the market.

Consideration Issue 1.8

The authors of this submission are not detailed expert in the area of margin loans. However, they have 25 years experience in teaching and researching corporate law.

Regulation of margin loans to directors (Section 1.4)

(1) The implications for market integrity of margin loans to directors

Margin loans to directors are an issue of policy and disclosure. As a consequence, clarity in relation to directors' margin loans impacts on market integrity.

(2) Should there be specific regulation of the process of entering into margin loans by directors? If so:
- Should it be left to individual companies to set the conditions under which directors can enter into margin loans?

Yes, we support this option for it is the most cost effective and efficient way to administer directors' margin loans. The reputation of the company dominates the individual benefits that arise from margin loans. Ultimately, it is the company's credibility that may be affected by margin loans to directors. Companies can develop risk management strategies to deal with such issues.[1]

Further, ASX/ASIC Companies Joint Update (29 February 2008) noted that a director of a company that is entering into a margin loan for a material number of listed securities may have to consider ASX Listing Rule 3.1 (Continuous Disclosure) which may operate to require disclosure of the key terms of the arrangements.

[1] Michael Adams and Thomas Clark, Final Report: Changing Roles to Company Boards and directors (September 2007), 48, <http://www.ccg.uts.edu.au/project_changingroles.htm> at 9 March 2009.

- Should the legislation require prior company approval before directors can enter into margin loans?

No, at this point in time, the cost of compliance does not warrant specific legislation in this area. The current rules dealing with directors' duties and continuous disclosure are enough to protect the interest of the company.

- Should the legislation impose limitations on margin loans to directors?

No, there should not be any legislation imposing limitations on margin loans to directors.

- Should the legislation prohibit margin loans to directors?

There is no evidence that the majority of directors are abusing margin loans. Further, there is no cost benefit analysis to prove that margin loans are bad for stock market or individual corporate entities.

Further, there is a risk that a margin loans may lead a director to commit insider trading without even realising it. The legislator should take this into account when considering insider trading rules and may introduce a new defence dealing with margin lending, where an automated sell of securities is required due to the terms and conditions of the margin loan.

Disclosure by directors to the company (Section 1.5)

(3) Should there be specific requirements for directors to disclose to the company that they have entered into margin loans? If so:

- Should it be left to individual companies to set the disclosure requirements?

It should be left to companies to set the disclosure requirements needed in relation to margin loans.

- Should the legislation require disclosure of entry into a margin loan?

No, the legislation should not introduce a specific disclosure requirement dealing with entry into a margin loan. The protection provided under s 191 should be enough. Further, the broad application of ASX Listing Rule 3.1 may cover such a situation. If a company is aware that a substantial holding of its director is subject to a margin loan, this may result in disclosure under Rule 3.1.

The ASX Listing Rule 3.19A states that a listed company has to notify the ASX of 'notifiable interests' which a director has in the company. A clarification may be introduced to ensure that 'notifiable interests' includes margin loans to directors.

- Should the legislation require disclosure of the details of a margin loan?

No, the legislation should not require disclosure of the details of a margin loan for the abovementioned reasons.

Disclosure to the market (Section 1.6)

(4) Should there be specific requirements for directors to disclose to the market that they have entered into margin loans? If so, what information should be disclosed (for instance, that the director has a margin loan, the number of shares subject to the loan or other details of the loan such as the circumstances in which a margin call could be made)?

As part of the ASX listing rule, there should be specific guidelines relating to disclosure of directors' margin loans.

Disclosure of directors' margin loans to the listed company they are working for is important to allow the company to disclose the margin loans to the ASX. Without such disclosure, the ASX rule 3.19A would not be applied as the ASX Guidance Note states that '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.'[2]

(5) Should directors be required to disclose to the market (or to the company, which would then disclose to the market) particular events that have occurred since entry into the margin loan and, if so, what events (for instance, that a margin call has been made or that the market share price was within a certain percentage of the margin call strike price)?

Yes, there is a need for directors to disclose to the company (which leads to a disclosure to the market) of particular events that have occurred since entry into the margin loan.

(6) Should the market disclosure requirements apply to all directors or only to those directors who are also substantial shareholders?

The market disclosure requirements should apply to all directors of listed companies.

Generic approach to disclosure (Section 1.7)

(7) Should directors be obliged to disclose to the company their interests or arrangements regarding their shareholdings or other equity-linked interests in the company, including financing arrangements?

Yes, the directors of public listed companies should be obliged to disclose their interests regarding their shareholdings or other equity linked interest in the company.

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[2] ASX, *ASX Guidance Note 22: Director Disclosure of Interests and Transactions in Securities-Obligations of Listed Entities*, para 8.

(8) Should a company be required to disclose to the market all information concerning those interests or arrangements of directors that investors would reasonably require?

Yes, a company should disclose such information to ensure the transparency of the market.

Consideration Issue 2.6

(1) The implications of blackout trading for market integrity

Blackout trading does have an impact on market integrity and helps to ensure that there is transparency in the market. It serves a similar goal to the continuous disclosure regime.

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

Yes, this is reinforced by continuous disclosure regime and the ASX Listing Rule 3.1 and the three years study conducted by Professor Michael Adams and Professor Thomas Clark in relation to the 'Changing Roles to Company Boards and directors'.[3]

(3) Should a more interventionist approach be adopted?

No, there should not be a more interventionist approach.

Consideration Issue 3.6

Initiating rumours (Section 3.3)

(1) The implications for market integrity of rumour-mongering

Rumour-mongering has a very negative effect on market integrity for it is contrary to the fundamental principles and objectives stated by the International Organisation of Securities Commissions (IOSCO): fairness, efficiency and transparency of the market. Today, fairness, efficiency and transparency of the market are incorporated into the *Corporations Act 2001* (Cth). In short, rumour-mongering may lead to market manipulation which is prohibited by the law due to its negative impact on market integrity.

[3] Michael Adams and Thomas Clark, Final Report: Changing Roles to Company Boards and directors (September 2007), <http://www.ccg.uts.edu.au/project_changingroles.htm> at 9 March 2009.

(2) Should all or some of ss 1041E, 1041F and 1041G be civil penalty provisions as well as attracting criminal liability?

Before making any changes to the current laws, a look at s 1041I is needed. Section 1041I notes that 'a person who suffers loss or damage by conduct of another person that was engaged in the contravention of s 1041E, 1041F, 1041G or 1041H may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention […].' Since civil liability is possible, civil penalty provisions should also be introduced in relation to these sections. This will also ensure consistency with other market manipulation provisions in the *Corporations Act*. This will also provide ASIC with flexibility to bring civil penalty actions in relation to such breaches without the need to prove the mental element.

(3) Should any of the elements of any of these three provisions be amended and, if so, in what manner?

Strict liability needs to be introduced in relation to proving the existence of certain elements.

(4) Should some form of compulsory recording of telephone conversations and other electronic forms of communication, such as SMS, be introduced?

Yes, compulsory recording should be introduced for listed companies only. Such companies would afford the cost that would be generated from compulsory recording telephone conversation and other electronic forms of communication. However, it needs to be made clear that such communications are being recorded so not to contravene the *Telecommunications (Interception and Access) Act 1979* (Cth).

ASIC may also be provided with powers to issue a warrant to intercept telephone or other electronic communication in case it suspect that market manipulation or insider trading are taking place. This will require the amendment of the *Telecommunications (Interception and Access) Act 1979* (Cth). Section 6C of the Act limits the issue of warrant on the application of 'an agency or an officer of an agency, or on an application by an eligible authority of a State'. An inclusion of ASIC in the list of agencies requires an amendment of s 5 (the interpretation section) to include ASIC into the list of 'enforcement agencies'.

(5) Any other steps to facilitate the detection and prosecution of rumour-mongering

Another step to facilitate the detection of rumour-mongering is through whistle-blowing and granting immunity to participants involved in market manipulation who blow the whistle on the activity. Further, the improvement of the continuous disclosure regime would improve detection of rumour-mongering.

Target response to rumours (Section 3.4)

(6) Would there be benefit in ASIC or the ASX providing further guidance on how companies should deal with market rumours affecting their securities?

No comment.

(7)In that context, would it be beneficial to adopt any of the principles in the FSA Market Abuse Directive Instrument?

No comment.

Recipients of rumours (Section 3.5)

(8) Would it be beneficial to develop best practice guidelines on how to deal with rumours received?

Yes, this would be very beneficial. It will protect investors and it will enhance transparency of the markets.

(9) if so, what should be the content of those guidelines, who should develop them and how should they be monitored or enforced?

In our opinion, the ASX Corporate Governance Council would be an ideal body to develop such guidelines.

Consideration Issue 4.7

(1) The role that analysts' briefings play in Australia's financial market and the implications for market efficiency and integrity of these briefings?

Analysts' briefings play an essential role in transmitting information as Australia has one of the world's highest levels of direct and indirect (mostly due to the compulsory superannuation regime) share ownership and thus ordinary investors need pure information. Accordingly, the importance of the existence of a level playing field to give equal access to information, through the use of modern technologies such as the internet and podcasts. Such briefing will keep the market better informed and this helps to achieve a more transparent market.

Public briefings

(2) Whether there should be greater guidance on what is required to ensure that the information provided in a public briefing is effectively and expeditiously disclosed generally? For instance, should all public briefings be webcast and/or podcast and in either case should a transcript of the proceedings also be provided?

Yes, there should be such a greater guidance. We need to use all the tools that are at our disposal to ensure integrity of the market. Greater guidance helps achieve such an outcome.

(3) Whether there are any approaches to public briefings of analysts in overseas jurisdictions that could usefully be adopted in Australia?

No comment.

Private briefings

(4) Whether private briefings to analysts increase market efficiency beyond what may be achieved through public briefings?

There need to be a research in this area: What evidence is there to prove that private briefing would increase market efficiency? Para 4.2.2 and 4.6 of the Issues Paper raised certain legitimate problems with private briefing.

(5) Whether particular issues arise in relation to compliance with, and the enforcement of, the insider trading and continuous disclosure provisions, and whether, or in what manner, those issues could be dealt with through further legislative or other initiatives. In this context:
- Should the equivalent of SEC Rule 100 Selective disclosure and insider trading be adopted?

Such an option may be desired. However further research on the advantages and disadvantages of SEC Rule 100 are desired.

- Should there be mandatory record-keeping requirements for some or all private briefings and, if so, of what nature?

Yes, we agree with the recommendation of the AIRA.

(6) 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?

No comment.

(7) Whether there are fairness or other equal access concerns with current practices regarding private briefings and, if so, how they might be dealt with. For instance:
- in what, if any, circumstances, would it be appropriate and feasible to require that all or part of the content of communications in private briefings to analysts be made available to investors generally, and
- if that content is to be made available, in what manner
- should the market be informed in advance of the timing of the publication of a listed company's financial results

Private briefings are particularly recommended in the case of capital raising.

(8) Whether any issues of intellectual property rights would arise in any move to require that the content of communications in private briefings to analysts be made available to investors generally and, if so, how they might best be dealt with?

The normal laws of intellectual property should provide sufficient protection.

(9) Whether there are any approaches to private briefings of analysts in overseas jurisdictions that could usefully be adopted in Australia?

We are unaware of other jurisdictions' laws in relation to this particular matter.

Conclusion:

The global financial crisis has caused many securities markets and capital markets to review the concept of *market integrity*. This Issues Paper (February 2009) reflects some of the current issues of debate on a global basis and we have tried to express the need for tighter regulation but on an efficient and effective basis. The lessons learnt from the rush of legislation post-Enron/WorldCom collapses (such as SOX legislation) that a huge cost burden being imposed on corporations for very little measurable public benefit. Our comments focus on a self-regulatory scheme, but all attempts to prevent market manipulation are worthy of a detailed examination to maintain the Australian securities markets integrity.

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