18 September 2017

Ms Deborah Bails
Market Supervision
Australian Securities and Investments Commission
Melbourne Vic 3001

By email: sell.side.research@asic.gov.au

Dear Ms Bails

ASIC Consultation Paper 290 – Sell-side research

The Australian Financial Markets Association (**AFMA**) welcomes the opportunity to make comment on the proposals to provide further guidance on managing conflicts of interest and material, non-public information (**MNPI**) involving sell-side research.

AFMA has sought member feedback on the *Consultation Paper 290: Sell-side research* (**CP 290**) and the draft Regulatory Guide 000 (**Regulatory Guide** or **RG**) set out in Attachment 1 to CP 290 and we have the following comments to make.

Defined terms used in this submission have the meaning given in the Regulatory Guide, unless otherwise specified.

1. Key comments

AFMA's key comments are set out in this section.

1.1 *More detailed guidance is welcomed*: AFMA endorses ASIC's appreciation of the value that IER's play in contributing to an effective price discovery process in the context of an IPO. AFMA welcomes ASIC's efforts to provide further guidance to the market regarding the management of conflicts in sell-side research. On the whole, AFMA believes its members and the market will benefit from more detailed guidance in this sector, that such guidance will create a more even "playing field" amongst licensees and, where necessary, raise the levels of conduct and compliance by market participants.

1.2 *Obligation to manage conflicts, not to prevent them*: AFMA notes the key legislative obligation of licensees that the Regulatory Guide is seeking to address

is the conflicts management obligation in section 912A(1)(aa) of the Corporations Act. AFMA believes that in its current form, the draft Regulatory Guide is seeking to prevent conflicts from arising (as demonstrated by the complete prohibition on valuation discussions or discussions regarding the content of IER's during the capital raising process), rather than to provide a framework that allows licensees to manage actual or potential conflicts. AFMA notes that ASIC has taken a prescriptive approach as opposed to a principles based approach to the guidance, and although AFMA supports more detailed guidance as noted in paragraph 1.1 above, the current prescriptive form of the Regulatory Guide appears to prescribe methods to prevent a conflict from arising. AFMA believes a more balanced approach should be adopted by ASIC. Moreover, many of the areas covered by the proposals in CP290 are already substantially covered in detail by regulatory guidance contained in ASIC Regulatory Guide 79 "Research Report Providers: Improving the Quality of Investment Research" (**RG79**), including management and disclosure of conflicts of interest, research reports based "on reasonable grounds" and for a "proper purpose", compliance monitoring, decisions about benefits and remuneration, disclosure of benefits and interests, information barriers, technological, physical and structural segregation, independent reporting lines, fact-checking of research by the issuer and corporate advisory and trading restrictions for research authors. Many of ASIC's proposals in CP290 unnecessarily duplicate this existing regulatory guidance.

1.3 *Significant impost on compliance and control room functions with questionable value*: AFMA notes the material requirements for compliance and control room monitoring, oversight, chaperoning and review that ASIC have required throughout the Regulatory Guide, in respect of the management of MNPI, through each stage of the capital raising process, and in respect of the structure of research. These requirements will require a significant economic investment to be made by AFMA members in their compliance and control room functions, to allow control room and compliance teams to be upsized to meet ASIC's requirements. The impact of these requirements will also no doubt be more significant for the mid-tier and smaller brokers who do not have global compliance and control room functions that already perform many of the tasks required by the Regulatory Guide. However, AFMA's key concern is that the increased compliance and control room supervisory functions may be form over substance and may not be an efficient means of addressing the mischief that ASIC seeks to prevent.

AFMA notes that the Regulatory Guide demonstrates a view by ASIC that research or corporate advisory professionals at licensees would fail to follow ASIC guidelines and internal policies absent compliance oversight, chaperoning or facilitation, and that analysts are neither professional nor independent enough to resist influence from their colleagues. AFMA believes this view is unfounded and excessive to apply across the industry as a whole, particularly given the importance of an analyst's professional reputation to maintaining their livelihood.

While ASIC has cited isolated examples to justify its position it is not good policy design to determine that a restriction is required based on single cases. It is the ongoing responsibility of ASIC to detect and deal through existing regulatory tools with undesirable behaviour by certain licensees that would not meet ASIC's expectations with regards to the conflicts management obligation. The prescriptive nature of the guidance imposes unnecessary restrictions on the industry as whole, as a result of the behaviour of a few. Further, the emphasis on compliance chaperoning to detect MNPI misunderstands the professional function and scope of competency of chaperoning which is to manage any undue pressure or improper influence applied to research analysts. It is not to detect MNPI or factual inaccuracies. Notwithstanding this, AFMA members already implement a number of compliance and control procedures around analyst and corporate advisory interactions and the preparation and publication of research reports, in order to comply with their conflict management obligations. AFMA believes these existing practices demonstrate an acknowledgement of and appropriate method of managing, the conflicts involved.

1.4 *Inconsistency with global standards:* AFMA notes a number of the proposals go further than rules in jurisdictions such as the United States, United Kingdom and Hong Kong. This is even taking into account the changes referred to in CP 290 that are being currently consulted on by the UK Financial Conduct Authority in relation to Initial Public Offerings or the current rules of the US Securities and Exchange Commission. For example, the restrictions on communications regarding valuation information, disclosure of interest requirements, certain of the record-keeping and monitoring obligations and the requirement for compliance and control room to facilitate communications and act as a "go-between" between issuers and analysts (without any involvement by the corporate advisory team) go beyond the requirements of other jurisdictions. AFMA's analysis of rules in other jurisdictions indicates to us that interactions between an analyst and an issuer do not need to be chaperoned or facilitated by compliance or control room. In the US, the provisions of the settlement decree is narrowly applied with regard to chaperoning and a chaperone is only required for meetings between corporate advisory and research analysts.

AFMA proposes that consideration should be given to framing guidance that more broadly addresses issuers and other market participants, by providing guidance on how those groups should engage in practices themselves that are consistent with the Regulatory Guide[1].

[1] In the US, FINRA has made a public statement about the importance of issuers respecting licensee's obligations. See FINRA FAQ: http://www.finra.org/industry/faq-research-rules-frequently-asked-questions-faq under "Communications or Conduct by Issuers"

1.5 *Transaction phases:* ASIC's central structure for Section D of the Regulatory Guide hinges on ASIC's four defined linear phases in the life cycle of a transaction that occurs before and after any capital raising mandate is awarded by an issuer. AFMA notes that the commercial realities of the timing and sequence of solicitation, vetting, pitching and execution activities do not always neatly align with ASIC's four phases and that flexibility will be required in order for licensees not to inadvertently drift from one phase to another, which may result in their actions unintentionally breaching ASIC's guidelines. In addition, the guidelines are not flexible enough to accommodate market practice where the imposition of inappropriate or unnecessary restrictions may adversely impact a licensees ordinary course research activities and the robustness of due diligence discussions that are beneficial to capital market transactions. Some phases can overlap (such as pre-solicitation and vetting), and vetting may continue during or after pitching has occurred, in the event that an analyst has been wall-crossed. Accordingly, AFMA proposes that fewer and clearly defined phases should be adopted (eg. "pre-pitch", "pitch" and "post-appointment") or licensees should explicitly be permitted to take a commercial view regarding which phase (or phases) they are currently operating under (and accordingly which restrictions on conduct must be observed). Further, the requirement for a signed mandate letter to be in place before an analyst can commence research preparation or publication, or conduct or otherwise have any involvement in due diligence, ignores the commercial realities of the process of formal mandate negotiation, where often a formal mandate letter is signed late in the process, if at all. These requirements, along with the restrictions on analyst participation in due diligence for the purposes of their research or internal risk approval processes until research is published and widely distributed to investors (which effectively means that analysts cannot contribute to these processes), will negatively impact transaction preparation, timetable, execution and ultimately the ability to successfully complete capital markets transactions.

Overall AFMA considers that these phases are insufficiently clearly defined, often overlap and do not reflect pre-deal process accurately. Further "vetting" is a function rather than a deal stage. The phasing is also inappropriate in the context of ordinary course research which is not transaction related.

1.6 *No clear distinction between pre-IPO and ordinary course research:* ASIC does not draw a clear distinction in the Regulatory Guide between interactions with a listed issuer and those with an unlisted issuer who is preparing for listing. Accordingly, in its current form, the guidance proposed in certain situations is inappropriate and unworkable when applied in the listed context. For example, where an issuer is already listed and covered by an analyst "ordinary course" discussions between an analyst and an issuer should be permitted at all relevant times unless and until an analyst has inadvertently received MNPI or has otherwise been wall-crossed as a result of a corporate advisory transaction. Until an analyst has inadvertently received MNPI or has been wall crossed in respect of a corporate advisory

transaction, an analyst covering that listed issuer must be free to undertake their ordinary course research activities, including meetings and discussions with their coverage companies and other companies in the relevant sector. In the case of listed issuers, the analyst will not be aware of a potential mandate on the corporate advisory side unless and until they are wall crossed in respect of the transaction (which would typically only occur shortly before the deal is announced to market, if at all, to avoid tainting the analyst and taking them out of the market). Taking analysts out of the market earlier than is usual (which would be required to comply with ASIC's requirements in Guidelines D1 and D3 that analysts and issuers do not discuss valuation information, and the restriction on analysts meeting with issuers during the pitching phase under D5) could tip the market off that a material transaction or material corporate action is pending. The foregoing practices should be maintained because they arise from, and reinforce, the independence of the research function from corporate advisory.

1.7 AFMA's view is that unless and until an analyst has inadvertently received MNPI or otherwise been wall-crossed in respect of the corporate advisory transaction, they should be free to interact with issuers (both listed or unlisted) as part of their ordinary course research activities - whether that occurs as part of one-on-one meetings with issuers, market briefings, or through attendance at industry conferences or presentations. Curtailing these discussions would impair the ability of the analyst to prepare informed and accurate research reports for their investor clients. Accordingly, AFMA proposes that Section D of the Regulatory Guide should only apply to IPO transactions, and not to listed issuers who are the subject of existing research coverage by analysts.

1.8 AFMA is submitting comments on the basis that Section D of the Guidelines only apply in respect of the period leading up to initial public offerings of securities by unlisted issuers, and not in the secondary market where follow-on offers of securities may be made by listed entities.

1.9 *Valuation information:* The term “valuation information” has been drafted in an overly broad manner extending to financial information (generally), as well as valuation methodology and market, competitor and sector comparisons. AFMA is concerned by such a broad definition, which may have unintended consequences, such as, by way of example, impeding valuable and legitimate communications on unobjectionable matters such as sector or peer group comparable company performance. We understand that ASIC may be focussed on the inclusion of valuation ranges in IERs. Whilst these ranges are valuable in terms of assisting with the investment bank vetting process and to the market understanding the issuing company, we think it is important that investment banks have visibility into the analyst’s views before proceeding with a transaction. This is, for example, important in protecting capital markets. Even if ASIC determined that these views should exclude valuation ranges, it should permit the investment bank to make its determination based on the analyst’s broader valuation views.

2. General observations - Section C of Regulatory Guide

2.1 Research analyst declaration RG 000.45

(a) Declaration regarding contact with the company

AFMA queries the value of the form of analyst declaration being proposed by ASIC. We consider that analysts should, as a general matter, as part of their ordinary course research, strive to have regular contact with the issuer they are covering; we query the value of this declaration and what ASIC is trying to achieve through its inclusion. We would further submit that in order for an analyst to obtain the necessary information to support their research coverage of a company, an analyst's interactions with the company should be expected and welcomed. We assume it was not ASIC's intention to discourage analysts from conducting the due diligence necessary to prepare high quality research.

(b) MNPI declaration

(i) AFMA is not supportive of this requirement, as it places the responsibility for determining whether information is MNPI solely on the analyst, in circumstances where the issuer must bear primary responsibility for ensuring that MNPI is not distributed to analysts. This requirement also does not take into account the fact that there can be a subjective or contextual element in determining whether information is material or price sensitive. Compliance teams cannot reasonably be asked to fulfil this role either. It is the obligation of issuers to adhere to their continuous disclosure obligations and ensure that analysts are not provided with MNPI.

(ii) The declaration about not being in receipt of MNPI *"and"* the research not containing MNPI is also difficult to reconcile with ASIC's later comments that an analyst's views on an issuer may itself constitute MNPI. Whilst AFMA members all currently have existing policies and procedures in place to address receipt and use of MNPI, we do not see the value of requiring the analyst to make this declaration. These internal policies of AFMA members typically restrict the ability of an analyst to publish where an analyst is in receipt of MNPI and have internal policies requiring analysts to report any MNPI in their possession to the firm's control room immediately upon receipt. At the very least, if a declaration were to be required, it should be qualified by knowledge and awareness. Further, AFMA questions the apparent assumption by ASIC that analysts are regularly in receipt of MNPI. With regards to listed issuers, analysts are expected to operate on the basis of, and should only be receiving from issuers,

publicly available information only. AFMA is of the view that any MNPI concern would be more appropriately addressed via requirements related to internal controls and procedures/policies implemented by licensees and issuers instead of shifting the primary potential legal liability on to the research analyst.

(c) Independence declaration

(i) AFMA does not believe a case for the value of this declaration is made out and that this proposal can be more appropriately addressed through the licensee's internal controls. From a professional perspective it undermines the analyst's reputation, their independence and professional integrity and implies that analysts are not able to resist any undue influence should it ever occur. Where research reports already include disclosures of the licensees' other interests as already required by ASIC RG79 (such as analyst shareholdings, and details of advisory transaction mandates on behalf of the issuer) this declaration will not provide any value to readers or contribute to management of conflicts.

(ii) AFMA also wishes to highlight that ASIC's proposed declaration is out of line with other pro-forma analyst declarations used in other markets and, as such, will cause them to have to introduce additional amendments to their local and global internal compliance and IT systems in order to ensure that any research prepared outside of Australia (that may be distributed into Australia or vice versa) incorporates ASIC's preferred form of analyst declaration. The implementation of this has both timing and cost implications for market participants in the Australian market and therefore if ASIC decides to proceed with this guidance it will need to be phased in over a period before any final guidance commences.

(iii) In the event that ASIC decides to proceed with this proposal there is a more appropriate alternative to ASIC's current proposed form of analyst declaration, AFMA recommends that ASIC consider the form of the SEC's Regulation Analyst Certification, which accompanies US analyst research:

I, [analyst name], hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

This form of analyst declaration addresses ASIC's views about analyst independence and is at least consistent with international practice and not requiring members to change their global compliance systems.

2.2 **Compliance and control functions - RG 000.49 and throughout**

(a) As noted in 1.3 above, AFMA members each have varying sized compliance and control room functions, and even for those Members with a comparatively large compliance function, ASIC's expectations in respect of the monitoring, chaperoning and record keeping obligations of these groups would require a significant re-sizing of those functions to meet them (possibly several additional headcount for larger firms depending on volume of transactions from time to time). At a high level, we note that ASIC appears to have taken a view that professionals at licensees (whether they be analysts or corporate advisory professionals) would fail to follow guidelines and internal policies absent compliance oversight, chaperoning, or facilitation and places a significant onus on compliance teams who are not well placed to determine the materiality or otherwise of information being disclosed to analysts, which may be of a highly technical and specialised nature. AFMA believes this view is unfounded and excessive, and although ASIC may have observed instances of past failures by certain individuals there is no demonstrated systemic failure. Individual lapses should not require all professionals to be subject to such stringent "hand holding" at each stage of the capital raising process. It is the role of the regulator to deal with individual cases and give appropriate guidance on a one-on-one basis. The proposed procedures will result in a significant cost and time penalty to licensees, and will inhibit the efficient and timely preparation and execution of capital markets transactions.

(b) It is also noted that some members do not have the ability to monitor communications in "real time", and the implementation of such a function would be extremely costly and would require a significant investment of both IT and employee time in order to be effective. With periodic monitoring already in place, AFMA does not believe this would provide incremental value in addressing the management of conflicts of interest.

2.3 **Request for research models**

(a) ASIC's requirement in RG 000.59 for licensees to have a process to deal with requests for research analysts models is noted. AFMA agrees that internal requests from corporate advisory can be (and already are) dealt with by members in the manner suggested by ASIC, however public side client (be that internal and external) requests for models are not (and should not be) subject to the same controls. Analysts often receive direct requests for copies of their models from public side clients, issuers, and,

at times, industry and academic contacts. Where there is no actual or potential conflict that arises as a result of these requests, AFMA does not believe such request would need to be managed by ASIC's suggested processes. Any financial model to be provided by an analyst would need to be materially consistent with a research analyst's published views on the covered issuer. AFMA therefore proposes that RG 00.56-00.59 should only apply to internal requests for models from corporate advisory.

3. General observations - Section D of Regulatory Guide

3.1 Pre-solicitation phase

(a) Guideline D1(c): ASIC proposes no discussion of valuation information by research analysts or by others when research are present

AFMA submits that at the pre-solicitation stage where so far as the licensee is aware the issuer has not decided or indicated its intention to proceed with a capital markets transaction, and so no role and no appointment has happened, there is no conflict. This means there can be no mischief afoot as a result of a valuation discussion in these circumstances. In particular, as noted above, where an issuer is already listed, and no mandate is currently contemplated (or corporate advisory is not present), an analyst may wish to discuss valuation matters with the issuer as part of their decision to initiate coverage, or where coverage is already in place, as part of their normal research and review activities (in which case, their published valuation and price target could be discussed).

(b) Guideline D1(f): ASIC proposes that research analysts should maintain a written record of any pre-solicitation meetings

As noted at 2.1(a) above, we query the need for making declarations regarding contact with issuer, and accordingly submit this requirement for written records is unnecessary and administratively burdensome. Analysts are expected to and do frequently have contact with companies they cover (including at industry events where there may be a significant number of companies represented, or through unscheduled inbound calls) and written records of any interactions should not be a prescriptive requirement. Further, as noted at 3.1(a) above, at the pre-solicitation stage, there is no "conflict" that needs to be managed, and accordingly requiring written records at this stage does not contribute at all to the management of conflicts.

3.2 Transaction Vetting phase

(a) Guidelines D2(a) and (c): - ASIC proposes that research and corporate advisory may not share or discuss valuation information

The restriction on discussions regarding "Valuation Information" at the transaction vetting stage removes a key diligence benefit to the corporate advisory team in determining whether to pursue a relationship with a particular issuer, and to underwriters tasked with deciding to commit the licensee's capital and reputation to a transaction. As ASIC notes at RG000.81 and RG000.82, many licensees consider an analyst's input on a company or potential transaction particularly valuable given their sector expertise. In a vetting process, an analyst is best placed to speak internally to market / buy-side views on sector positioning or valuation information, and based on their sector knowledge, to the quality of the business model, risk factors, growth prospects and appropriateness of capital structure etc. Input on these matters may be critical to the corporate vetting process, including to determine whether the issuer's (or corporate advisory's) views on price or valuation information are realistic.

(b) Guidelines D3(a) - (c): ASIC have proposed that research analysts should not interact directly with the issuing company; communications should pass through compliance / control function, analyst should forward questions to compliance who will pass them to the issuer

As we noted in paragraph 1.4 of our key comments, the approach taken here is too restrictive. During pre-IPO period and post-IPO mandate period, interactions between a research analyst and an issuer should be permitted on an unchaperoned basis. Where an analyst is asked by its corporate advisory team for their input or advice as part of a transaction vetting stage, an analyst should be permitted to have unchaperoned discussions with the issuer and not be limited to having to forward written questions via compliance / control function. In addition, during the "solicitation period", which begins when an issuer makes known that it intends to proceed with an IPO and ends when there is a bona fide awarding of an underwriting mandate (whether verbal or in writing), research may only meet with the issuer to undertake bona fide vetting and due diligence (on the basis that there is no discussion of preliminary valuation ranges or fielding questions on how to position/ communicate with investors).

3.3 **Transaction Pitching phase**

(a) Guidelines D4(a) and (b): ASIC proposes that research should not communicate with or discuss the company or potential transaction with corporate advisory, including discussing or sharing valuation information

As ASIC notes in RG00081, 00082 and 00083 an analyst may be asked for their input and advice as part of transaction vetting. It is critical that an analyst always be able to provide their input into any vetting, if requested. Vetting and pitching may not always occur in in the linear sequence that

ASIC has described - they can in fact occur in the reverse order, and can significantly overlap. AFMA is of the view that an analyst should be able to provide their input into a vetting process, if requested - prohibiting research from communicating with or discussing the issuer or potential transaction with corporate advisory where vetting and pitching are overlapping or vetting follows pitching is overly restrictive.

3.4 **Post-mandate phase**

(a) RG 000.88 and Guideline D5(a): ASIC proposes that before the capital raising mandate is signed, research should not communicate or meet with the issuing company or its advisers

(i) The restriction in D5(a) on communications prior to signing of a mandate is likely to prove unworkable in capital raisings, for example where there is a short dated timetable, or where no mandate will be signed (which is often the case in secondary capital raisings, where the only relevant agreement between the issuer and the licensee is the underwriting or lead manager agreement, which is signed just prior to announcement). AFMA proposes that the requirement for a signed mandate should (if at all) only apply to IPOs, subject to the following comments.

(ii) AFMA does not believe the absence of a formal mandate letter, which is often the subject of lengthy negotiations, should preclude an analyst from meeting with an issuer and commencing research preparation. Analysts are not involved in the mandate letter negotiation process, and the negotiation of these documents should not impede an analyst's involvement in the transaction. Research analysis is an independent process. It follows that a research analyst should not be affected by the signing of a mandate letter by corporate advisory because they are an independent business unit on the public side of the information barrier wall.

Furthermore, verbal contracts, or contracts by conduct, are not unusual in capital markets transactions. In addition, there are a number of factors that contribute to a delay in the signing of a mandate letter that are unrelated to research - these include negotiations on fees and roles (particularly where there are numerous syndicate members), rights of first refusal, indemnities and information warranties. Even though a formal mandate has not been signed, once roles are verbally awarded the joint lead managers will start preparing for the IPO, including due diligence work and providing the full suite of corporate advisory services to their client.

(iii) This requirement has the potential to significantly delay the preparation and execution of a capital raising transaction. In difficult markets where the window of opportunity to successfully complete a deal can be short and change rapidly, delays such as this have the potential to significantly impede transaction execution and result in adverse consequences for the market and investors.

(b) RG 000.89: Analyst input into internal approval processes not permitted prior to publication of IER

(i) As part of their internal underwriting/transaction risk assessment, some AFMA members require the analyst to attend a commitments / risk / underwriting committee call or meeting where they will be asked to speak to their research and their views - including valuation information and their specific valuation. Practice varies between members, but the corporate advisory deal team may be present on the call when the analyst is discussing their views. All members would as a matter of policy have representatives from legal and/or compliance on these calls.

(ii) It is a fundamental component of any licensee's underwriting risk assessment, that they be able to take into account the results of their analyst's research (including valuation information) and be able to obtain the benefit of the analyst's views on the company, the sector and the results of their independent due diligence. As noted above, the analyst's sector knowledge and expertise forms a crucial part of a licensee's assessment of the merits of the IPO and the issuer. As this process is managed carefully by senior personnel of the licensee who sit on the commitments / risk / underwriting committees with legal or compliance present on relevant calls or meetings. AFMA proposes that this practice be permitted to continue. For many members, analyst input on these calls and meetings will only occur just prior to finalisation of the IER. The discussions are not held to question or challenge an analyst's views and are not used as a forum for comments or changes to reports or valuations - they are simply to obtain the analyst's views on the issuer such that those views can be considered as part of internal risk assessments by the licensee.

(iii) Publication of an IER is an important step in the transaction preparation stage and licensees will only proceed with publication should their commitments / risk / underwriting committee be comfortable with the merits of the issuer and the transaction - prohibiting the input of an analyst into this risk process could have a significant detriment on the willingness of licensees to proceed with capital markets transactions. The prohibition proposed by ASIC contrasts with regional and international regulation. This means regionally-based risk committees will be able to get greater information and comfort on IPOs in Asian jurisdictions, such as Hong Kong and Singapore, than Australia. This may well impact international underwriters' desire to underwrite Australian equities in contrast to those listed in Australia's main competing markets.

(c) Guidelines D6(d): ASIC proposes that an IER should not be used to communicate information not reasonably be expected to be included in the prospectus

(i) As ASIC would be aware, IER's can include a substantial amount of information that is not included in the prospectus, such as the analyst's own views on the issuer and its business, including risk factors, analyst views on the market and sector in which the issuer operates, a strength/ weaknesses / opportunities / threats analysis and discussion of peer group comparables. In some instances, an analyst may wish to provide their financial forecast that goes beyond the prospectus forecast period. The analyst's views as expressed in the IER will be informed by both the disclosure in the draft prospectus, the analyst's own experience, publicly available information and knowledge of the relevant sector. On the basis that this information could not reasonably be expected to be included in the prospectus (as it is not the issuer's information), we would assume that ASIC does not take issue with the inclusion of this information. If this assumption is incorrect, we would submit that this information forms the core part of the value of the IER - without it, an IER would simply be repeating the content of the prospectus without independent analysis which would be of minimal if any use to investors.

(ii) Whilst AFMA agrees that valuation information must be based on the financial information in the prospectus, we would like to clarify that this requirement does not restrict an analyst from applying a valuation method that requires consideration of periods outside of the prospectus forecast period (such as discounted cash flow analysis). Further, in cases where the analyst believes they have a reasonable basis to provide a financial

forecast beyond the prospectus period (for example, in the case of a REIT that has a long weighted average lease expiry with stable, known earnings), AFMA would submit that these valuations should not be restricted - the analyst should be left to independently determine whether they can provide views that extend beyond the prospectus (subject always to there being a reasonable basis for their views).

(d) Guidelines D6(e): ASIC proposes that an IER may not be released for fact checking until signed mandate is in place

Mandates are awarded by various means. They usually commence with an oral or email confirmation from the issuer client and then may proceed to be documented in letter agreement form. However, in some circumstances, the parties conduct themselves in all relevant ways on the basis of a final draft letter agreement that has been negotiated, although that letter is never ultimately executed. Further, in some circumstances, a formal mandate letter is neither negotiated nor executed and the parties only enter into a long-form underwriting or offer management agreement (which would generally occur after the publication of an IER). Accordingly, AFMA proposes that this restriction on the timing for release of an IER is impractical and inconsistent with how transactions mandates are documented or concluded. As noted above at RG 000.88, a delay in execution of a mandate may occur for a number of reasons and does not necessarily imply that finalisation of the mandate is being used by the issuer as a tool to influence an analyst's valuation.

(e) RG D7(b) - (e): ASIC's proposal that corporate advisory and analysts should not communicate about the issuer before the IER is widely distributed, other than in respect of administrative matters

Refer also to our submissions above at RG000.89 and below at Guideline D10(f) regarding the value of analyst input into the licensee's internal risk considerations and review of the issuer and the merits of the transaction. We believe the proposed restriction will significantly impact the analysis and risk management processes that can be undertaken by licensees.

(f) RG D8(a): Analyst may attend a briefing after the transaction mandate has been signed

Reference the signing of the mandate letter is not in AFMA's view an appropriate milestone for the commencement of analyst briefings (for the reasons noted in sub-paragraph (d) above). Accordingly, having an analyst limited to a briefing or site visit after signing is illogical. Given the late stage in which many mandates are signed, ASIC's approach could place inappropriate time pressure on analysts to reach a view or simply make providing research on many IPOs impractical. This could lead to errors in research content or no useful content being made available.

(g) *RG D8(b): ASIC's proposal that compliance should attend the analyst briefings, which may include site visits*

(i) AFMA proposes that imposing this requirement will result in significant cost issues for licensees and its value is unclear in particular:

(A) where sites are in regional or remote areas and compliance personnel are based in other Australian locations or overseas jurisdictions;

(B) in busy markets where there is significant capital markets activity, will require licensees to engage in significant hiring to be able to send a person to each and every such meeting; and

(C) where there are more cost and logistically effective alternatives, such as engaging the support of experienced external legal counsel as opposed to requiring each licensee's compliance team to provide resources.

(ii) This requirement highlights the lack of confidence in licensees' policies and procedures that is evident in the overall approach that ASIC has taken in the Regulatory Guide. AFMA members have pointed out that international practice gives a guide on what safeguards can be relied upon to assist in managing issuer/research interactions. For example in the solicitation period (as that term is used in the US), a notice is sent to the issuer about what the analyst is permitted and not permitted to do in the meeting. The issuer is then on notice that any discussions are "one way" conversations (i.e., the analyst is there to ask questions only, not engage in a two way dialogue). This notice is only used when in the solicitation period.

(h) Guideline D8(e): Analysts should not communicate their views on the issuing company, the transaction or any valuation information before the IER is widely distributed

AFMA considers this guideline is inconsistent with D9(a), which allows a redacted version of the report to be distributed to compliance, the issuer and its legal advisers for fact checking; and consistent with our submissions regarding analyst participation in internal risk committee processes at RG 00089 and due diligence at Guideline D10(f) below, is overly restrictive with the potential to significantly impede transaction preparation, analysis and execution.

(i) Guideline D9(c): Corporate advisory may not review a copy of the draft IER before it is widely published

(i) In the view of AFMA, members of the corporate advisory team (along with their internal and external legal teams) should be permitted to perform a fact checking review of a redacted version of the draft IER before it is finalised. Corporate advisory are the best placed employees of a licensee to review the report to ensure there are no factual inaccuracies, or inconsistencies with the prospectus in relation to the issuer's business, as these employees are the most familiar with both the issuer and the draft prospectus. In an IPO scenario, for example, corporate advisory will commonly be involved in the issuer's formal due diligence committee meetings held to facilitate the issue of the prospectus. Members of the compliance team are not familiar with either the issuer or prospectus and are not involved in issuer due diligence. This review has generally proved an important tool in ensuring quality and consistency of disclosure. Further, we submit that once the IER has been finalised internally by research management, an un-redacted version of the IER may be provided to the corporate advisory team just prior to publication for a final "sense check", provided that:

(A) any review is facilitated by compliance or control room;

(B) all comments on the IER are communicated via compliance or control room;

(C) only chaperoned conversations may take place between corporate advisory and research in respect of the IER review; and

(D) only correction of factual inaccuracies or errors is permitted.

AFMA believes the risks associated with corporate advisory being involved in the fact checking process and being aware of the final valuation prior to publication can be appropriately managed.

The corporate advisory team should be given the opportunity to see the final valuation prior to publication, as it may impact their considerations regarding price and value, and corporate advisory should also have the opportunity to confirm the valuation is based on the correct understanding of the financial information and business model of the issuer, and otherwise does not contain any errors or mistaken assumptions / qualifications. Any errors identified by the parties at this stage could be fixed with necessary independent approval of research management and oversight of the relevant compliance / control room. However, no other changes would be permitted to the report prior to publication.

(j) Guideline D9(e): ASIC proposes that a final copy of the IER may only be provided to the issuer after it has been widely distributed

AFMA considers it unlikely that issuers would be comfortable with the distribution of an IER on their (still private) company in circumstances where they had not yet seen the valuation information in that report. In an IPO context where an issuer is yet to determine whether they will offer their shares for sale and at what price, it is commercially unreasonable to expect them to allow distribution of research that contains an unknown valuation range and methodology.

(k) Guidelines D10(a) - (b): ASIC proposes that an IER should not be amended, updated, reissued or replaced following publication

AFMA is unsure why ASIC would propose to prohibit the amendment or updating of an IER once it has been published, particularly where the amendments were to correct a manifest error, or required as a result of a change in circumstances of the issuer (for example, as a result of an applicable regulatory change). An IER is generally published prior to finalisation of the pathfinder prospectus, and accordingly there is the potential for the draft prospectus information on which the IER is based to change following publication, including as a result of changes to the issuer's circumstances. In these instances, we do not believe that an update to an IER would be problematic. Withdrawing a report in this instance is unnecessary. We would suggest that in these circumstances, the updated report be redistributed to all recipients of the original report and be required to include a rationale for the change (i.e. a description of the error or change in circumstance or issuer information), so the change itself along with the reason for the update is made clear to readers and all readers are made aware of the change.

(l) Guideline D10(f): ASIC proposes that analyst participation in due diligence may only occur after the IER is published

AFMA proposes that this requirement will effectively prevent the analyst from participating in any review or analysis by the licensee of the issuer or the transaction in a timely manner. As ASIC would be aware, the IER is published prior to finalisation of the pathfinder / prospectus, however only at a time where the prospectus is in its final stages of drafting (such that the issuer and its advisers are confident that no material changes will be made to the draft prospectus that has been provided to analysts, and on which they will be basing their research reports).

3.5 ***Discretionary Fees***

A discretionary fee is a positive tool for issuers to reward quality of service. While we understand ASIC may think this gives rise to conflicts of interest, AFMA believes these concerns are overstated. Obviously, a licensee should have robust measures to prevent any business unit from acting inappropriately. However redacting fees altogether means there are costs of the issue not shown to an analyst which may be relevant to economics. More importantly, however, the risk is mitigated by other control measures including that an analysts' remuneration is not determined by the transaction's outcome and there is a supervisory and/or research committee review of an analyst's output.

4. General observations - Section E of Regulatory Guide

4.1 Structure of research - RG 000.125(f)

AFMA notes that it is not practical or efficient for members to publish their full policies publicly online and they propose to publish summaries of such policies. As noted above, RG79 already requires disclosure of conflicts management policies.

4.2 Decision-making on coverage – RG 000.127

AFMA queries the usefulness of the requirement to publish a licensee's process on how it selects a company for research coverage and the decision and rationale by the licensee to initiate or terminate coverage of a company. We would submit that this may also create the unwanted effect of putting licensees at higher risk of receiving unwanted and undue pressure on research coverage and potentially impact on their independence - for example, if on reading a licensee's policy on initiating coverage, an issuer believes they meet the requirements for coverage to commence, they may apply considerable pressure to the analyst or the licensee in that regard. Further, the rationale behind coverage decisions may depend on a host of variable factors, many of which may not be within the control of a licensee

(eg staff capacity). By requiring a licensee to publish how it selects a company for research coverage, it may require a licensee to heavily qualify such disclosure so as to make such disclosure not particularly meaningful. We believe the proposed guidance in Guideline D1(b) would address the same concerns.

4.3 **Disclosure of interests - RG 000.130 - 131**

a) AFMA notes that it is unclear what constitutes a "material interest" in financial products (noting that section 671B of the Corporations Act does not require public disclosure of relevant interests of less than 5%). The proposed wording suggests that information of no value would have to be gathered. AFMA can see no basis for this. Further:

   (i) We note ASIC's proposal that this disclosure should extend to details of shares and options held by the analyst and the five largest shareholders at the licensee. AFMA notes whilst disclosure of personal holdings of analysts who contribute to the report are standard (and can be easily confirmed), licensees do not maintain registers of all shareholdings of other employees and this information would be incredibly difficult (and time consuming and costly, particularly in large or global financial institutions with many separate business units) to collate and maintain such that it was accurate and up to date. AFMA also queries what value would be obtained from extending disclosure beyond those analysts who have prepared the report, especially as it may relate to immaterial holdings. Other employee shareholders may have no connection to the research or corporate advisory departments, and when the analyst holdings are added to the other suggested disclosures regarding benefits and roles, such disclosure should be sufficient from a conflicts perspective.

   (ii) Further, we seek clarification that ASIC does not expect the licensee to disclose holdings in the company held by the licensee and its related entities - these holdings could be confidential and sensitive (and the analyst will not be aware of those holdings), and the disclosure of those holdings could constitute MNPI. Such holdings should only be required to be disclosed in accordance with the Corporations Act.

AFMA notes that it is unclear how a licensee could determine what benefits they "are likely to receive" from the issuer and what time period would apply to this consideration. Further, AFMA notes that there is no concept of materiality of benefits received. It is common for firms to have internal policies that limit an analyst from receiving benefits beyond a certain threshold level from third parties. Material expenses are not relevant for

disclosure and are not required to be disclosed in other markets. The monitored policies and procedures that members have in place to limit gifts or entertainment to de minimus amounts address the issue of conflicts of interest. It follows that there is no need to disclose such matters. As noted above, RG79 already contains detailed regulatory guidance on disclosure of interests and benefits.

b) AFMA also queries the intention behind the requirement in RG 000.130(d). Interactions between a research analyst and the issuer in and of itself should be normal course research activities that should take place to allow a research analyst to have visibility over the issuing company's business. To consider these interactions, such as site visits, as "assistance" that requires disclosure would seem to suggest that such interactions might give rise to a potential conflict of interest, which AFMA suggests is not the case. AFMA proposes that the proposed SEC Regulation Analyst Certification declaration would be the better tool to speak to the independence of an analyst's views than requiring these specific disclosure of "assistance", in particular where there is no concept of materiality applied to this requirement.

c) AFMA further notes that it is unclear what ASIC expects to be disclosed regarding the "reasons behind the opinions and recommendations in the research", as this would usually form part of the research report itself. The reasons for an analyst's views or changes in recommendations are already set out in the report. Moreover, RG79 already contains detailed regulatory guidance on content of research reports, including reasons behind the analyst's opinion.

4.4 **Research funding**

Guideline RG 000.135(c): ASIC proposes that the research team's budgeting and expense allocation should be reviewed on an annual basis by an independent oversight function such as an audit committee

AFMA queries the effectiveness of this requirement. It is submitted that the guidelines in RG 000.135 (a) and (b) are sufficient to ensure the independence of the research function. Provided that a licensee's internal guidelines and policies already factor in these requirements, it is not clear to AFMA what an independent audit review process would add to the safeguards (other than simply asking if these policies were followed).

5. Application to other financial products

AFMA proposes any regulatory guidance arising from CP 290 should be limited to equities sell-side research. There are fundamental differences between fixed income and equities markets. These include not only how deals are conducted but also the very nature of the information being dealt with (including its price sensitivity) and the timing and nature of interactions. We would support separate guidance applying to manage any potential conflicts of interests associated with 'bond sell-side research', noting separate consultation and regulation is the approach having been undertaken by FINRA in the United States. Any proposed policy guidance should be subject to separate consultation by ASIC.

AFMA notes that in light of the different views and practices of its members, members will be making separate submissions and, accordingly, ASIC should not assume that members otherwise endorse or agree with any proposal not covered in this AFMA submission.

6. Regulatory and Financial Impact

CP 290 seeks comments on the regulatory and financial impact of the proposals. Among our key comments we noted the material requirements for compliance and control room monitoring, oversight, chaperoning and review that ASIC have required throughout the Regulatory Guide, in respect of the management of MNPI, through each stage of the capital raising process, and in respect of the structure of research. These requirements will require a significant economic investment to be made by AFMA members in their compliance and control room functions, to allow control room and compliance teams to be upsized to meet ASIC's guidance. The impact of these requirements will also no doubt be more significant for the mid-tier and smaller brokers who do not have global compliance and control room functions that already perform many of the tasks required by the Regulatory Guide.

As AFMA has often noted in submissions, predicting likely compliance costs is an inexact art. However, it is clear that there are implementation and ongoing costs always associated with changes to systems, processes and procedures, as well as ongoing costs associated with ongoing compliance with the RG. This extends to matters such as direct and indirect compliance staff costs; monitoring and review costs (for e.g. surveillance monitoring, audit and business line control); research analyst and research management time and effort; corporate advisory staff time and effort; and both internal and external legal costs. There will also be economic implications for AFMA members, which will have to divert some resources away from revenue generating activity to achieve full compliance with the RG.

As an indicative figure for the type of large member banks that AFMA has we estimate based on member feedback the ongoing 'fully-loaded' cost of additional local Compliance resources alone to be in the vicinity of AUD 500 thousand dollars.

This figure would need to be multiplied across the number of large licences affected by the proposals with a lower compliance cost expected for the mid-tier brokers.

In line with the Government policy commitment of ASIC and the other regulators to ensuring that licensees can meet their obligations with a minimum amount of additional regulatory burden or additional cost impost on industry, AFMA is of the view that these high costs can be significantly moderated by pursuing a more balanced and less prescriptive approach than is currently contemplated in line with our comments in this submission.

Please contact me (02) 9776 7995 or by email dlove@afma.com.au if further general elaboration is required. This submission has been prepared in close collaboration and with the support of AFMA's partner member Baker & McKenzie with our key committees, most particularly the Capital Raising Committee. If you have any more technically focussed queries regarding this submission either Lauren Magraith (02 8922 5161) or Craig Andrade (02 8922 5364) at Baker & McKenzie would be pleased to assist you.

Yours sincerely

David Love
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