Law Council
OF AUSTRALIA

Business Law Section

20 September 2017

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Dear Ms Bails

Sell-side Research Response to Consultation Paper 290

Introduction

This submission is made by the Corporations Committee of the Business Law Section of the Law Council of Australia (**Committee**) in response to Consultation Paper 290 *Sell-side Research* published by the Australian Securities and Investment Commission (**ASIC**) in June 2017 (**Consultation Paper**), to which is attached draft ASIC Regulatory Guide XXX: Sell-side research.

1 General comments

The Committee believes the Consultation Paper is a valuable initiative and provides useful guidance to financial services licensees.

We understand ASIC's concerns around the management of conflicts, handling of material non-public information (**MNPI**) and the possibility of pressure being placed on research analysts about valuations or their approach to valuations, and support ASIC's desire to ensure consistently high standards across the market.

We broadly support many aspects of ASIC's proposed guidance, and specifically ASIC's proposals:

- regarding the need for controls to identify and manage MNPI (although we believe it is unrealistic to expect the compliance/control function to identify instances where MNPI has been received (see Proposal B7), and that instead compliance/control's role should be to assist in managing such instances, which research should be responsible for reporting – in this regard, we note that identification of MNPI is not really something that falls within the expertise of the compliance/control function) (Proposals B1, B2 and B3);
- confirming that corporate advisory and other parts of an investment bank's business must not seek to inappropriately influence research views or valuations (various parts of Parts C and D of the Consultation Paper);
- prohibiting research departments participating in the solicitation of corporate advisory mandates (various parts of Part C of the Consultation Paper);
- prohibiting the issuing company and its other advisers (including independent financial advisers) placing undue pressure on research analysts to prepare research that is favourable to the issuing company (various parts of Parts C and D of the Consultation Paper);
- regarding discretionary fee arrangements (Proposal D6); and

- regarding the funding of research departments and organisational structure of the research department within a licensee (various parts of Part E of the Consultation Paper).

In light of our general support for much of ASIC's approach, we do not intend to address each of the questions posed by ASIC in the Consultation Paper, but instead:

- have made general observations on the Consultation Paper where we think proposals could potentially have unintended adverse consequences for appropriate and ordinary course analyst interactions, and for the quality of sell side research, and for the capital markets as a whole, and have then focussed on some specific issues that we believe should be addressed; and
- also note that we generally support AFMA's submission on the Consultation Paper, which we have seen, and which contains more detailed observations on a number of ASIC's proposals.

We would make two other general points at the outset.

We believe that valuation ranges in investor education reports (**IERs**) are valuable (both to the investment bank in the transaction vetting process and to the market in understanding the issuing company), but we understand that this is a particular area of focus for ASIC. However, it is also very important in our view that those in an investment bank responsible for determining to go forward with a transaction[1] have some level of visibility on analyst conclusions at the time they determine to proceed with the transaction (this protects the capital markets). While we consider that it would be best that such visibility extend to the valuation range, it would be better for this determination to be informed by visibility of the analysts' research insights (excluding the valuation range) than for it to be taken entirely without visibility of analysts' views.

A final general point is that we are concerned that a number of ASIC's proposals do not sufficiently distinguish between pre-initial public offering (**IPO**) research and research in the context of secondary raisings by existing listed companies, and are potentially unworkable in the latter context. We address this in further detail below.

2 Pre-release communications and pre-release visibility of research conclusions

We consider that it is important to distinguish between:

- interactions between analysts and issuing companies prior to release of research – which are obviously essential in the formulation of research based on reasonable grounds; and
- interactions between research analysts and other parts of an investment bank prior to the release of research, including its commitments or underwriting committee and the corporate advisory team – which are also valuable, and at some level essential, but which are generally more limited and controlled.

Both of these types of interaction have a significant and beneficial role in capital raisings for the reasons set out below and are in accordance with international practice and regulations.[2]

[1] Generally a commitments or underwriting committee comprising very senior individuals, and with representation by the legal / compliance function. See further below.

[2] We note, for example, that in response to Question 1 of the FINRA FAQs on "Solicitation and Marketing" FINRA states that it recognizes that "vetting and due diligence communications enable the research analyst to assess the issuer for underwriting commitment purposes, to gather or confirm information about the issuer to comply with the disclosure obligations of the federal securities laws, and to gather information on behalf of investors".

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2.1 Diligence and information gathering

Access to information from the issuer is essential in order for analysts to properly inform themselves and ensure research conclusions have a reasonable basis.

Such interaction is particularly critical in an IPO context since, in a non-continuous disclosure environment, there is often much less information available to research analysts as a basis to commence their due diligence investigations.

Information prepared by the corporate advisory team may also be an important source of due diligence information, particularly initially. Interaction between research analysts and corporate advisory typically takes the form of an initial briefing of the relevant analyst in which details of the transaction, timetable and company background are provided, and the analyst has an opportunity to ask questions. Corporate advisory may also provide additional information to the research analyst to assist with due diligence and preparing the IER, with opportunities for the research analyst to ask further questions. These interactions support the IPO process as the research analyst may identify reputational, business or other risks relating to the issuer or proposed transaction that need to be addressed as part of execution of the transaction and/or preparation of the issuing company for listing.

The interaction with the issuing company provides the research analyst with additional detailed information regarding the business and operations of the issuing company, as well as an opportunity to ask questions directly of the issuing company. This interaction with the issuing company is important and we do not believe there is any reason why it should be subject to particular controls[3] – the management of issuing companies should always have the opportunity to explain how they view strategy for their business and operating environment, as they will need to do throughout the rest of the company's listed life, and research analysts should, to the extent they need to do so, be able to interrogate and test management assertions.

2.2 Transaction vetting

In the context of an IPO, transaction vetting is a rigorous and important internal check and balance in the process of evaluating whether a proposed transaction is one which an investment bank should participate in. Developing a valuation and valuation methodology is important to the vetting process, and contrasting corporate advisory and research analyst opinions are important matters for the bank to consider in evaluating whether to participate in a transaction.

ASIC has previously indicated that it expects various categories of intermediaries, including investment banks, to perform a 'gate keeper' role, and it is important in this context that banks' decisions to go forward with a transaction are fully informed – not just by the corporate advisory team (which may be quite "invested" in a particular project) but also with knowledge of the views of the research department.

In the Consultation Paper, ASIC acknowledges the importance of vetting, but in our view:

- fails to acknowledge that valuation information is an important input to that process (ASIC suggests that research and corporate advisory may share views in the vetting process on almost all subjects other than valuation – see Proposal C2); and
- assumes that transaction vetting only occurs prior to mandating, and indeed prior to pitching.

Transaction vetting decisions are taken at different stages by different investment banks, but most banks, in addition to earlier consideration before pitching or mandating, will also have an important meeting of their commitments or underwriting committee or other senior decision-making group shortly before the process of investor education commences. These committees generally comprise very senior executives, and generally

[3] Except that we agree that valuation should not be debated.

hear from the corporate advisory team which is “sponsoring” the transaction and also have visibility on the independent research conclusions.

We have experience of decisions being taken at this stage not to proceed with marketing a transaction, or to proceed on a different pricing basis, and those decisions would have been informed by the knowledge of the conclusions (including valuation conclusions) of the independent research. Research department personnel are not inappropriately questioned about their conclusions (indeed, sometimes they are not physically represented, or are represented only by senior research personnel, and in any case, representatives of legal and compliance are generally also present), but the conclusions are a key data point in determining whether or not a transaction should go forward, and on what basis, and we submit this is entirely appropriate and protects the capital markets.

Sometimes, although rarely, differences of opinion between corporate advisory and research analysts on valuation and valuation methodology are ventilated (typically either via or in the presence of legal and compliance), and we submit this is entirely as it should be. Were a research analyst to misunderstand or misinterpret information provided, or make other errors, the misunderstandings or errors can be corrected through these interactions before the research is published. Prior to the publication of research, corporate advisory often has the benefit of possessing the most recent factual information from the issuing company. Additionally, as a “proxy” for the buy side investing clients, the research analyst will provide valuable and significant views on valuation and valuation methodology which will enable corporate advisory to (as necessary) recalibrate their approach on executing the transaction and the timing and manner of its execution and to manage the issuing company’s expectations. The vetting process may also draw on an analyst’s views of the issuer’s most relevant peer companies, or industry sector or sub-sector (this has been especially important in recent years with the emergence of new industry sub-sectors, and the blurring of boundaries between traditional industry sectors).

Banning these types of interactions regarding valuations (as opposed to ensuring they proceed subject to appropriate controls) risks harming the capital raising process because differences of opinion would only become known to the issuing company and corporate advisory after the research has been published, by which time the bank would have committed to the transaction (in circumstances where earlier access to the analyst’s conclusions might have prevented this), and any error by the analyst may be very difficult to correct.

The conflicts that arise from these discussions can be managed effectively with appropriate controls, as discussed below.

2.3 Post-mandate period – a fully informed capital raising process

Once a corporate advisory team has been mandated to advise on a particular transaction, the corporate advisory team will be responsible for guiding the issuing company through the capital raising process, including playing a major role in assisting with preparing materials for potential investors, preparing the prospectus and providing advice in relation to pricing.

During the process of preparing the prospectus, appropriate interactions between corporate advisory and public-facing research analysts can provide valuable insights into what information potential investors would reasonably require for their decision to invest in the issuing company, for example information relating to the issuing company's industry, peers and key external industry risks. This is particularly important for corporate advisors assisting issuing companies with the preparation and drafting of an IPO prospectus, where the issuing company is required to satisfy the disclosure test in section 710 of the *Corporations Act 2001*.

Controlled discussions with research analysts can also provide corporate advisory with important information (including information about market sentiment and market valuations) in deciding whether to proceed with the transaction. Draft valuation information provided by research can provide corporate advisory with an indication about

whether the proposed offer will be attractive to potential investors. This information may be critical in deciding whether to proceed with the transaction.

Restricting all discussions about valuation information until after the IER has been published may potentially place the issuing company in a difficult situation, where a transaction is launched and the company's private information becomes public, in circumstances where it is later revealed that the transaction was unsustainable.

These important discussions in the post-mandate period can be facilitated by the legal or compliance function to ensure that no undue pressure or influence is exerted on analysts re their research valuations.

2.4 International practice and regulation

We consider that a number of ASIC's proposals to limit the interaction between analysts and corporate advisory, and between analysts and issuing companies, are out of step with international practice and regulation.[4]

We believe that ASIC's proposals should be adapted to allow interactions with appropriate controls rather than absolutely prohibiting the sharing of certain types of information.

3 A control based solution to interactions between research, corporate advisory and the issuing company

We agree (as outlined in paragraph 79 of the Consultation Paper) that access to IERs plays a helpful role in price discovery for IPOs.

As noted above in section 2, we also believe that controlled interactions between corporate advisory and research analysts and between research analysts and issuing companies play an important and valuable role in the IPO context, and that conflicts of interest can and should be managed by regulating interactions between those parties, rather than by prohibiting interactions or prohibiting the sharing of certain types of information.[5]

Each investment bank has its own controls and policies depending on, for example, its resources and regulatory environment, and we believe that there are many ways in which conflicts of interest and the risk of "bullying" of analysts can be managed. In this regard, we believe that the costs and effectiveness (based on empirical evidence) of very prescriptive regulation of interactions between analysts and corporate advisory should be carefully considered before promoting one form of regulation over another. In particular, an unduly inflexible requirement for "chaperoning" (particularly if that term is prescriptively interpreted) may add significant cost and uncertainty, whereas a more substantive approach (permitting each AFS License to assess the risk and require legal or compliance involvement in situations where there is a practical risk of "bullying" of analysts) may better achieve ASIC's aims. We further note that chaperoning is not mandated by regulation in many major financial centres including the United Kingdom, Hong Kong, Singapore or Canada.

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[4] For instance, FINRA has indicated that it would not be inconsistent with FINRA regulations (relating to the prohibition on research analysts participating in the solicitation of corporate advisory business and the prohibition on offers of favourable research) for corporate advisory to consult with analysts about valuation and other views during the solicitation period. This can be contrasted with ASIC's proposals to prohibit corporate advisory and analyst research interactions during the "pitching" phase and prohibit any discussion of valuation during the "vetting" phase. FINRA also states that it believes that potential issues relating to issuing companies applying undue pressure on analysts during the pre-IPO period can be effectively managed by an investment bank's policies and procedures. The UK FCA requires that potential conflicts of interest be managed and that research's objectivity be preserved but does not prohibit these interactions.

[5] This approach is consistent with international best practice, including as set out by FINRA and the 2003 global analyst research settlement agreed with US regulators by a group of investment banks. We note that at the time that the research settlement was negotiated, regulators specifically considered the issue of whether to ban interactions or sharing of particular types of information, and came to the conclusion that regulating (rather than completely prohibiting) interactions was the preferable approach.

Key features of appropriate controls and policies to manage conflict of interest in analyst / corporate advisory interactions include:

- not linking the performance evaluations and compensation of research analysts to specific corporate advisory mandates;
- not permitting performance evaluations and compensation of research analysts to be subject to input from corporate advisory personnel;
- physical and information barriers, including appropriate wall crossing procedures to manage MNPI. In particular, a research analyst must be wall crossed prior to receiving any MNPI about a potential transaction or upon the investment bank determining that the analyst has received MNPI;
- separate reporting lines for research and corporate advisory and approval processes for research and transaction vetting;
- internal training and policies governing the interactions and significant penalties for breach;
- interactions between ***research analysts and corporate advisory*** generally being permitted at the following times and on the following conditions[6]:

Phase	**Research analysts and corporate advisory Interactions – Proposed policies and procedures (which are broadly consistent with US/international standards)**	**Research analysts and corporate advisory Interactions - ASIC's proposed position in the Consultation Paper**
Pre-solicitation	• Unlisted companies – interactions permitted. • Listed companies – interactions permitted, excluding valuation related information (unless the issuing company is already covered by research and the communication is consistent with published research).	• Interactions between corporate advisory, research and issuing company permitted, but no discussion of valuation information allowed if research analyst is present.
Pitching/ solicitation	• Interactions permitted, subject to appropriate controls, e.g. facilitated by / occur in the presence of, personnel from legal or compliance or an appropriate internal control function. • The research analyst can engage in discussions with, and receive information from, corporate advisory about the issuing company and the transaction for the purposes of information gathering and commencing their due diligence. This information will supplement the information provided directly to the research analyst by the issuing company. • Whilst approaches differ amongst banks, the research analyst and corporate advisory can usually	• Interactions prohibited. No discussions of valuation information.

[6] We note that the phases addressed below do not include a separate "vetting" phase since, in our view, that is a function that is performed right up until immediately before an IER is released. This is an important point, and is addressed further in section 5.2 below.

	discuss valuation related topics such as valuation methodology, peer companies, etc. These interactions help inform ongoing transaction vetting.		
Post-mandate	• Interactions permitted, subject to appropriate controls, e.g. facilitated by / occur in the presence of, personnel from legal or compliance or an appropriate internal control function. • Research analyst and corporate advisory can discuss valuation, valuation methodology, peer companies, etc subject to appropriate controls, e.g. facilitated by / occur in the presence of, personnel from legal or compliance or an appropriate internal control function. Corporate advisory may also provide further information (for example, draft prospectus, financial information, etc.) to the research analyst to assist with the research analyst's continuing due diligence and preparation of the IER. • Once the draft IER has been prepared and the Research Department Review is complete (see below), a redacted draft of the IER may be provided to corporate advisory for fact checking[7]. The fact checking process is facilitated through legal, compliance or other control function (although that function does not, and is not qualified to, itself undertake substantive checking of research). • However, the commitments or underwriting committee or similar senior body has visibility of final research conclusions, including in relation to valuation, when it considers whether and the basis on which the transaction will be allowed to go forward, as a key and final part of transaction vetting (see further below).	• Interactions prohibited, other than with respect to administrative matters (and with compliance oversight). No discussion of valuation information. • Research analyst views on valuation may not be shared outside of research team or legal and compliance before the IER is widely distributed. • Analyst requests for additional information outside of these briefings must be passed through compliance. • No fact checking of draft IERs by corporate advisory.	

- interactions between ***research analysts and the issuing company*** are permitted at the following times and on the following conditions[8]:

Phase	**Research analysts and the issuing company – Proposed policies and procedures (which are broadly consistent with US/international standards)**	**Research analysts and the issuing company - ASIC's proposed position in the Consultation Paper**

[7] In this submission, "redacted" means redacted to exclude all mentions of the valuation range, valuation methodology and related information.

[8] Refer to footnote 6. The phases addressed below do not include a separate "vetting" phase since, in our view, that is a function that is performed right up until immediately before an IER is released. This is an important point, and is addressed further in section 5.2 below.

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Pre-solicitation	• Unlisted companies – interactions permitted. • Listed companies – interactions permitted, subject to compliance with ordinary course research rules that include prohibitions on discussing unpublished research views[9].	• Interactions between corporate advisory, research and issuing company permitted, but no discussion of valuation information allowed if research analyst is present.
Pitching/ solicitation	• Interactions permitted (subject to notification to the issuing company to reinforce rules of the road for interactions), and not required to be facilitated by, or occur in the presence of, personnel from legal or compliance or an appropriate internal control function. • The research analyst can engage in discussions with, and receive information from, the issuing company about the issuing company and the transaction for the purposes of information gathering and commencing their due diligence. It is not permitted to exchange views on valuation related matters.	• Interactions prohibited, other than written communications passed through compliance. The issuing company may not ask questions of the research analyst.
Post-mandate	• Interactions permitted, and are not required to be facilitated by, or occur in the presence of, personnel from legal or compliance or an appropriate internal control function. • The research analyst may attend management presentations on the issuing company and the transaction and otherwise speak to or communicate with the issuing company. Once again, the research analyst will not discuss any valuation range with the issuing company, but may speak to valuation methodology and peer companies (and valuation range information may be conveyed to the issuing company via corporate advisory). • Once the draft IER has been prepared and the Research Department Review has been completed (see below), a redacted draft of the IER may be provided to the issuing company and their legal advisers for fact checking. The fact checking process is facilitated through the legal, compliance or other control function (although that function does not, and	• Interactions permitted, provided that they are facilitated by, or occur in the presence of, personnel from legal or compliance or an appropriate internal control function (including briefings and site visits). • No discussion of valuation information between the research analyst and the issuing company • No participation by corporate advisory in any communications between the research analyst and the issuing company. • A redacted draft of the IER may only be provided to the issuing company and their legal advisers for fact checking. The fact checking process is facilitated through the legal, compliance or other control function.

[9] As part of the ordinary course function of research, an analyst will often meet and communicate with private companies in order to inform his or her views on the particular sector and on companies under coverage (for example, the private company may be the primary competitor of a covered company). If at any point during these interactions the analyst receives material non-public information relating to a proposed IPO transaction, the licensee's internal controls and procedures are designed to ensure that such receipt of information is notified to the appropriate internal legal or compliance function so that they may consider further action, such as wall-crossing the analyst.

is not qualified to, itself undertake substantive checking of research).

- prior to providing a redacted draft of the IER to the issuing company or corporate advisory for fact checking, the draft IER is reviewed and approved by a separate research committee or other peer review quality assurance process involving participants from research management or senior research personnel. This review process challenges the draft valuation, valuation methodology, views of peer companies, assumptions etc., to ensure that the research department is comfortable with the approach taken by the research analyst and the views put forward in the IER. Corporate advisory does not participate or input into this work stream. After the draft IER has been through this review process, any substantive changes must also be signed off through this review process (**Research Department Review**); and
- as part of transaction vetting and prior to the publication of the IER – senior research personnel (and sometimes the research analyst) will attend and participate in (or, depending on the circumstances, provide a memo that is tabled at) the commitments or underwriting committee that will either approve the bank's participation in the transaction or determine not to proceed. At the committee meeting, a summary of the research analyst's conclusions on the issuing company and the transaction, including their views on valuation, is presented.

4 Issues with potential adverse market implications

We are concerned that some of ASIC's proposals may have adverse implications for ordinary course, appropriate interactions of research analysts and the market.

4.1 Proposal C2 – Transaction vetting

As noted in paragraph 62 of the Consultation Paper, research analyst input on a company or potential transaction is a valuable part of the transaction vetting process.

As noted in earlier sections, the Committee is concerned that ASIC's proposal to limit the interaction between corporate advisory and research departments while a transaction is being vetted, and in particular the limitations on the ability for research to give feedback on valuation information (in the course of the transaction vetting process) in internal discussions or meetings with the licensee's corporate advisory staff, could limit the inputs into the transaction vetting process, potentially compromising the decision whether or not to proceed with and how to position the transaction.

We understand that any valuation information shared with corporate advisory as part of the transaction vetting process is only shared after it has been approved by the senior research personnel through the separate Research Department Review. As such, the valuation information has been "finalised" from the perspective of the research analyst once it has been finalised by the research review committee but before it is provided to the commitments or underwriting committee.

The transaction vetting process is a very important one, as noted above, and we understand that the participation of senior research personnel in that process is also very important.

The process is a rigorous one, in which an investment bank evaluates whether a particular transaction being put forward by the corporate advisory team is appropriate for the bank to participate in. This process may bring to light that a potential issuer is not ready to list or undertake an IPO. We would expect ASIC to also view this process as important, given the focus it has placed on the 'gate keeper' role of various categories of intermediaries, including investment banks.

Valuation and valuation methodology is an important consideration in the vetting process, and any differences of opinion between corporate advisory and research departments are important matters for a bank to consider in deciding whether to participate. Removing the ability of the relevant internal teams to understand and interrogate a research analyst's views on valuation and valuation methodology removes an important information source.

Large international and domestic investment banks are conscious that their participation in a transaction can be interpreted as a signal by the market about the calibre of the issuing company and the proposed transaction. Not only is the transaction vetting process designed to protect the investment bank from participating in riskier transactions, it also serves to protect the market from such transactions – ensuring that they are either not brought to market or, if they come to market, do so without the backing of a credible international or domestic investment bank, or do so at a price and with disclosure which adequately addresses the inherent risks.

ASIC's proposals would remove valuable interactions that should rightly take place as part of a rigorous transaction vetting process. This would weaken important internal controls and could allow riskier transactions to be launched than might otherwise have been the case.

4.2 Proposal D4 – Reviewing draft IER (fact checking)

This Committee does not agree with ASIC's proposal to limit the participation of corporate advisory functions in fact checking draft investor education reports.

Although ASIC notes that balance between ensuring the factual accuracy of the IER and avoiding the risk of research analysts being pressured to change their views before publication is important, it is paramount that research be accurate and ASIC's proposals potentially place that objective at risk.

IPO IER is prepared outside of the continuous disclosure environment, and there is generally less publicly available information available to the research analyst. In these circumstances, there is a greater need for there to be an effective feedback loop to ensure that any fundamental inaccuracies are corrected prior to publication of the IER (particularly if the only remedy where the IER is found to be inaccurate after publication is for that report to be withdrawn rather than corrected).

Corporate advisory teams (along with the issuing company's other advisers) are central to the preparation of the prospectus and other roadshow materials to be used in connection with the transaction. As such, they (together with the issuing company's other advisers e.g. legal advisers) are well placed to provide factual feedback on the draft IER. The issuing company and their advisers who participate in fact checking research reports bring their own different perspectives in reviewing the IER – all of which affords the market, regulators and the issuing company more comfort that first and foremost the research is accurate, consistent with (and captures) all the underlying financial and other information to be disclosed in the offer document, and does not contain any fundamental errors.

For example, the corporate advisory team play an important role in fact checking the financial and industry information in the IER, and have in our experience identified oversights or errors which the issuing company and its legal adviser did not readily identify given such facts may not be specific to a particular company. As such, we are concerned that an unintended consequence of removing all parties other than the issuing company and its legal adviser from fact checking draft IERs will be to significantly increase the risk that the research reports will contain factual errors that will require correction post publication. There is a real risk that this will damage the quality and therefore the credibility of research in an IPO context, which is the opposite of what we understand ASIC intends to achieve by issuing this guidance.

We recognise ASIC's concern that the fact checking process could potentially be used to pressure research analysts to change their view in a draft IER before its distribution to investors. However, we are of the view that the research analyst can be adequately

protected by ensuring that draft IER provided for fact-checking has valuation information redacted[10] and the fact checking process is facilitated by the compliance (or other internal control) department at each of the banks (we note in this regard that compliance departments will not be able to, and should not be expected to, contribute substantively to the process, as they will lack the relevant business expertise, but communications should pass through them to ensure a research analyst is not placed under pressure in the guise of fact checking).

4.3 Proposal D5 – After publishing the IER

This committee does not agree with ASIC's proposal that the research analyst be prohibited from amending or updating their IER once it has been published. While we understand ASIC's concerns, we are once again concerned that there may be adverse consequences for the market if an IER can only be withdrawn in the event of a material change or new circumstance once the research has been published.

In our experience (although this is uncommon), during the IPO process there are a range of reasons why new information may come to light, including late in the process (for example, the issuing company may have available an additional month of trading data, an unexpected event outside of the issuing company's control may have occurred e.g. a material regulatory change may occur, a new material contract may have been signed, a new financing facility may be procured, etc.). New information (whether positive or negative for the issuing company) may be important for investors to assist them to form their view on the issuing company and ultimately whether to invest. In circumstances where new information arises that will be included in the prospectus and is material to valuation conclusions in the IER, it seems to us to be appropriate that IERs can be supplemented to include this new information.

If emergence of any updated or changed information means that the research must be withdrawn (without explanation), the market may automatically assume that the reason for the withdrawal is that new negative information has been identified. This may make it impossible for the issuing company to complete the transaction, and will not assist investors to make informed investment decisions.

Material new updates or amendments to the research reports can be appropriately chaperoned by compliance (including through the senior research review process described in section 3) in order to ensure that any changes to an analyst's conclusions arise solely as a result of the new information and not as a result of undue pressure being applied by the issuing company or corporate advisory.

5 Other general observations on the Consultation Paper

5.1 Normal course research versus pre-deal research

The Consultation Paper does not distinguish between IPOs and capital raisings for existing listed companies, and we are concerned that some of the proposals in the Consultation Paper would be potentially unworkable in the context of listed issuing companies.

MNPI is not usually (and should not be) given by issuing companies to research analysts preparing ordinary course research, because of the disruption that it would cause to ordinary course research coverage.[11] For example, until the research analyst is wall crossed (which is delayed to the last minute – if at all – to minimise disruption to ordinary course coverage), or the transaction is publicly announced, the research analyst won't know of a confidential proposed capital raising, and could inadvertently breach the restrictions regarding potential capital raising processes.

[10] In this regard, we note that the COBS rules of the UK FCA only prohibit the review of drafts for factual accuracy if they contain a recommendation or a target price.
[11] Should an analyst receive MNPI, that would be managed through the bank's existing internal controls (being basic to operating effective information barriers).

In those circumstances, where the relevant analyst has no knowledge of a potential transaction, ordinary course interactions with management are appropriate and should be permitted in order for the analyst to be able to continue to provide coverage. Even if corporate advisory is soliciting for underwriting business, provided that the research analyst is not wall-crossed or is not otherwise in possession of MNPI, his or her ordinary course interactions with the issuing company should be permitted to continue and should not be regarded as part of the pitching process.

If ASIC's proposals were adopted, even where the research analyst had no knowledge of a potential transaction, and (quite appropriately) had not been informed of a pitching process or potential capital raising, the research analyst would not be permitted to conduct continued ordinary course conversations with the issuing company, nor to discuss any financial information or to discuss prior research. Prohibiting such interactions is likely to result in a research analyst suspending coverage, and risks tipping the market that a transaction is contemplated.

We suggest that ASIC clarify in its guidance to make clear that normal course research coverage is to be permitted alongside normal course interactions between the issuing company and research (without the research analyst receiving MNPI) unless and until such time – if at all – as the relevant analyst is wall crossed in relation to the particular capital raising.

We note that there is no practice of having deal-specific IER in the context of a secondary offer.

5.2 Phases of the capital raising process

In the Consultation Paper there is a distinction drawn between phases, for example the "solicitation" and the "vetting" phases. These distinctions are more nuanced in practice. We understand that it is for this reason that FINRA chose to narrowly define "solicitation"[12], but otherwise sought to identify only two other capital raising phases – pre-solicitation and post mandate.

Additionally, we believe it is important not to confuse *functions* that occur during the capital raising process (and may occur on multiple occasions during the process) with *phases* of the capital raising process. In this regard, we note that "vetting" is a function that is undertaken by a bank during the capital raising process, rather than a distinct phase of the process, as discussed above.

In our experience, it is also generally not the case that a mandate letter is signed immediately when an investment bank is appointed to a role on a capital raising – in fact it is far more frequently the case that signing of the mandate letter is delayed until well after a bank has effectively been appointed and is working on the transaction (and sometimes a mandate letter is never signed). Mandate letters can of course contain important terms that go to liability or rights to terminate, and in our experience, are often negotiated over time following effective appointment. Once the investment bank has been notified of and accepted the appointment, and while the formal mandate letter is being negotiated, the investment bank commences work on the transaction. Contrastingly, and having regard to the time delay between effective mandating of the bank and the signing of the mandate letter, FINRA approaches the issue of determining when the "solicitation"

[12] In the response to question 1 in FINRA FAQ's, FINRA states "In general, FINRA considers a solicitation period to begin when the issuer makes known that it intends to proceed with an IPO and ends when there is a bona fide awarding of the underwriting mandates. While typically a solicitation period will commence with a request for proposal from an issuer or other communication that will expressly indicate an intent to proceed with an IPO, firms must carefully assess the context and content of a request for information from an analyst by an issuer during an ostensible pre-IPO period to assess the risk of complying with the request. … With respect to the end of a solicitation period, to the extent an issuer determines the deal participants on a rolling basis, a solicitation period would end for a particular firm when it is informed that it has been awarded a role in the offering or has been rejected for a role.

phase ends and the "post mandate" phase commences by reference to when a bank is informed that it has been awarded a role in the IPO or has been rejected for a role.[13]

Equivalently, from the research analyst's perspective, whilst they will be notified that the investment bank has been appointed on a particular transaction, they will not know when/if the mandate letter is formally signed (or in existence). As with the corporate advisory team, they will seek to commence working as soon as the appointment is confirmed rather than waiting until the formal mandate is signed. The signing of the formal mandate is irrelevant to the research analyst, and holding off commencing work until the mandate letter is signed limits the time that they have to get to understand the issuer and formulate their views, potentially harming the quality of research.

5.3 Draft IERs may contain more than prospectus information

In the Consultation Paper. ASIC proposes to limit the content of the IERs (particularly in relation to forecast financial information) to information included in the prospectus or, in the case of listed issuing companies, the information disclosed to the market.

Whilst the information provided to the research analyst ought to be consistent with the prospectus and, in the case of listed issuing companies, the information disclosed or to be disclosed to the market, we do not see why the analyst should be prevented from expressing their views in the research reports on matters that the issuing company would not include in the prospectus (for example, discounted cash flow analysis). What other information the research analyst needs to include (and considers it appropriate to include) to support their views in the IER is a matter for the independent judgement of the research analyst. The research report reflects the views of the research analyst, and subject to complying with the internal policies of the relevant bank, it is not clear to the Committee why the IER should be limited to the information in the prospectus or market disclosures.

Indeed, to impose such a limitation would appear to interfere with the analyst's independence.

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[13] See footnote 12 for further detail.

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In addition to the measures suggested by the Consultation Paper, we would support ASIC acknowledging that it expects issuing companies and other licensees to be respectful of the regulatory obligations under the final Regulatory Guide of licensees participating, or competing to participate, in capital raisings. This approach would provide a helpful deterrent that publicly recognises that effectively managing the risk of conflicts arising in this area is a shared responsibility of issuers and market participants (including boutique advisors).

If you have any questions regarding this submission, in the first instance please contact the Committee Chair: Rebecca Maslen-Stannage on rebecca.maslen-stannage@hsf.com or (02) 9225 5500.

This is a complex and important area that goes to the availability of capital for innovation and growth in the Australian economy. The Committee would encourage ASIC to seek the views of market participants and would welcome the opportunity to present in person or to be involved in further consultation as the consultation process proceeds.

Yours sincerely

Teresa Dyson,

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