ASIC

Australian Securities & Investments Commission

REPORT 486

Sell-side research and corporate advisory: Confidential information and conflicts

August 2016

About this report

This report sets out key observations from our review of the way financial intermediaries handle material, non-public information and manage conflicts of interest. It considers the interaction between financial intermediaries' research and corporate advisory activities.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the *Corporations Act 2001* (Corporations Act))
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

Executive summary

1 The proper handling of material, non-public information (MNPI) and the management of conflicts of interest (conflicts) promotes market integrity, improves market efficiency and increases investor confidence.

2 Australian Financial Service (AFS) licensees are subject to a range of obligations in s912A of the *Corporations Act 2001* (Corporations Act), including the requirement to provide financial services efficiently, honestly and fairly, and to have in place adequate arrangements to manage conflicts.

3 We have previously released guidance that sets out our expectations of how financial intermediaries (firms) should handle MNPI and manage conflicts.

Note 1: In this report, a reference to 'firms' includes investment banks, market participants, securities dealers, independent research houses and corporate advisory organisations (most of which hold an AFS licence).

Note 2: See Regulatory Guide 79 *Research report providers: Improving the quality of investment research* (RG 79), Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181), and Report 393 *Handling of confidential information: Briefings and unannounced corporate transactions* (REP 393).

4 This report sets out our findings on the identification and handling of MNPI and the management of conflicts. These issues have been reviewed in the context of sell-side (or broker) research and corporate advisory activities.

5 We examined the policies, procedures and practices of a range of Australian-based firms (both large and mid-sized) and a sample of transactions.

Note: In this report, 'large firms' refers to investment banks, most with an offshore parent, who typically advise on transactions over $100 million. 'Mid-sized firms' refers to firms that are usually domestically owned and operated, and generally advise on transactions of less than $100 million.

Findings

6 Many firms have policies and procedures to address the handling of MNPI and management of conflicts.

7 We found that some firms do not have appropriate arrangements to handle situations where staff (including research analysts) come into possession of MNPI. This includes inadequate use or supervision of restricted lists and information barriers (traditionally known as Chinese walls). This can result in MNPI being handled inappropriately, including by being passed to the sales desks or to preferred clients.

8 We identified some inconsistent practices in how conflicts are managed, including a lack of research independence and appropriate separation of research and corporate advisory activities. The structure of some firms contributed to this, including inadequate physical and technological separation, remuneration models, and reporting lines that may encourage inappropriate behaviour. This can affect the independence and quality of

research and increase the risk of undue influence from corporate issuers, their advisers, or the firm's own corporate advisory team.

> Note: In this report, 'technological' includes information technology, file servers, email, chat and instant messaging, and electronic order pads.

9 We found that it is common among mid-sized firms for staff to receive allocations and to trade in securities of the companies for which the firm is managing a capital raising. We have concerns that staff trading can lead to personal interests taking precedence over client interests, which can result in poor advice and poor outcomes for clients. This risk is heightened around the release of research and capital raising transactions.

10 We also considered other risk areas such as how shares are allocated in capital raising transactions and the use of 'Director clubs'.

Next steps

11 In this report, we highlight areas that firms should review to ensure they are compliant with Australian legal and regulatory requirements. The findings in this report also have broader application across a range of activities that firms engage in beyond research and corporate advisory. We will provide individual feedback to the firms that participated in this review and will expect them to address any issues we raise with them.

12 Firms should consider whether their controls, including policies, procedures, training and monitoring are appropriate and meet legal and regulatory requirements. Firms should give careful consideration to the handling of MNPI and conflicts to ensure they are adequately managing the risk of insider trading.

13 We have achieved some enforcement outcomes where we have identified instances of poor conduct in this area. We are conducting further inquiries with firms to test how they handle MNPI and manage conflicts. We will seek enforcement outcomes where we consider there has been conduct that is unlawful under the Corporations Act, *Australian Securities and Investments Commission Act 2001* (ASIC Act) or other applicable legislation that we administer, and which otherwise meets our criteria for enforcement action.

14 We intend to follow up this report with industry consultation on proposed guidance to ensure that good research practices are followed. Feedback on the issues raised in this report is welcome and can be sent to confidentiality.report@asic.gov.au.

> Note: We will not treat your feedback as confidential unless you specifically request that we treat whole or part of it (such as any financial information) as confidential.

15 We are also undertaking a review of the practices used by firms to market initial public offerings (IPOs) to investors, other than institutions. This includes the use of social media and other platforms. A separate report will be released later this year.

A Background and scope of the review

Key points

The proper handling of MNPI and the management of conflicts promotes market integrity and efficiency and increases investor confidence. In this section, we outline:

- the background to our review and why MNPI and conflicts are a focus area for ASIC;
- what we mean by MNPI and conflicts; and
- the scope of our review.

Background

16 Financial markets play a critical role in the Australian economy, enabling businesses to raise capital from investors and price and allocate risk.

Note: In the period January 2014 to May 2016, approximately $170 billion was raised through equity markets in Australia. This comprised around $71 billion from initial capital raisings and $99 billion from secondary capital raisings, see ASX, *Market statistics*.

17 To operate effectively, markets need to be fair and efficient, and investors must have trust and confidence in their operation. The proper handling of MNPI and management of conflicts promotes market integrity and efficiency and increases investor confidence. Our review considered these issues in the context of research and corporate advisory activities.

18 Research assists both retail and institutional investors in making decisions about investment products: see RG 79. It is important to the integrity of our financial markets, and to the quality of financial advice provided to investors, that research is unbiased and reflects the professional judgement and expertise of the research analyst.

19 Research analysts regularly interact with listed companies. These interactions can increase the risk of the company disclosing MNPI to the research analyst. Poor practices in the handling of this information can threaten market integrity and increase the risk of insider trading.

20 Corporate advisory activities include the provision of capital raising and advisory services to companies and are generally undertaken by investment banking, corporate finance, equity or debt capital market firms or teams within firms. Corporate advisory assists companies to raise capital (debt and equity) and undertake corporate transactions (such as mergers and acquisitions and takeovers).

21 Corporate advisory staff regularly come into possession of MNPI. Physical and technological barriers usually separate these areas from the public or trading side of the firm (including research and sales). Where corporate advisory wants to discuss MNPI with a person outside their team, the person should be wall-crossed.

22 Where MNPI is mishandled or conflicts are not managed appropriately, there is a risk that a breach of financial services law may occur. For example, insider trading, market manipulation, misleading and deceptive conduct, and breaches by AFS licensees of their general obligations: see Appendix 2 for a summary of the relevant legislative provisions.

23 This report builds on previous work by ASIC on the handling of MNPI, management of conflicts, and issues identified in our ongoing monitoring and surveillance activities.

24 In July 2014, the Federal Court of Australia found Newcrest Mining Limited (Newcrest) contravened its continuous disclosure obligations and required Newcrest to pay a civil penalty of $1.2 million: see *Australian Securities and Investments Commission v Newcrest Mining Limited* [2014] FCA 698. In a series of briefings, Newcrest had disclosed MNPI to a number of research analysts. Following the court's decision, we continued our investigation into related persons that received MNPI from Newcrest, and have written to the relevant firms setting out recommendations on measures they can implement to strengthen their control frameworks.

25 We also wanted to determine whether conduct seen overseas was evident in the Australian market. For example:

(a) The US Financial Industry Regulatory Authority (FINRA) identified conduct that resulted in a settlement with Toys 'R' Us, Inc. (Toys 'R' Us). In December 2014, FINRA announced that ten firms (eight of which have affiliates with a presence in the Australian market) had poor conflict management when they used their research analysts to solicit an IPO mandate and offered favourable research coverage to Toys 'R' Us.

Note: Toys 'R' Us asked equity research analysts to make separate representations to it for the purpose of ensuring that the research analysts' views on key issues, including valuation factors, were aligned with the views expressed by the firms' investment bankers.

(b) The Japanese Financial Services Agency (FSA) recently took action against Deutsche Securities Inc. and Credit Suisse Group AG for inadequate handling of MNPI and for using the information to solicit orders from customers.

26 Concerns about proper handling of MNPI and management of conflicts by research analysts and corporate advisory teams have led to a number of

regulatory reforms in international jurisdictions, including the United States and Hong Kong. The United Kingdom is also looking at the capital raising process, including research and corporate advisory. Some of these reforms have led to changes in the way AFS licensees with global investment bank affiliations operate in the Australian market. A summary of regulatory responses from international regulators is set out in Appendix 3.

Key focus areas

27 This report focuses on two related issues in the context of research and corporate advisory activities undertaken by firms—MNPI and conflicts—and involved a review of the matters set out in Table 1.

Material, non-public information

28 Firms regularly receive confidential information, including information that is price sensitive, because of the nature of the business they conduct. Poor practices in the handling of this information can threaten market integrity.

29 For the purposes of this report, we focused on MNPI, which is information that has not been made public, and that a reasonable person would expect to have a material impact on the price or value of securities or derivatives.

Conflicts of interest

30 Conflicts may arise within a firm because of the possession of MNPI and, more generally, when there are conflicting duties to corporate issuers and investing clients. These duties can also conflict with the business interests of the firm and the personal interests of its employees. This includes actual, apparent or potential conflicts.

31 Conflicts can be exacerbated by a firm’s business model, business practices, physical layout, remuneration structure, and shareholdings in companies held by the firm or its staff. Where conflicts are not adequately managed, they have the potential to undermine confidence in financial markets and can pose a threat to investor protection.

Table 1: Scope of the review

Newcrest	A review of the compliance and risk frameworks of the firms involved in the Newcrest matter to assess any deficiencies in the handling of MNPI. In particular, we looked at the actions of research analysts who received MNPI from Newcrest.
Poles and wires	An inquiry in to the circumstances surrounding debt research published by UBS Securities Australia Ltd (UBS Securities) on the privatisation of NSW electricity infrastructure dated 17 March 2015. As a result of this inquiry, and in light of the Newcrest matter, we were concerned that UBS Securities' control framework for its research function (and its compliance with that framework) was not adequate at the relevant times for an investment bank of UBS Securities' size and complexity. UBS Securities acknowledged these concerns. In response to our inquiries, UBS Securities implemented remedial steps to improve its control framework for research. This included changes to the structure and oversight of research, enhancements to policies and procedures, and additional staff training. An independent expert was appointed to review the implementation of these remedial measures. As a result of these measures, we took no further action on this matter.
Thematic review of large and mid-sized firms	We reviewed policies and procedures and met with firms to assess their controls for handling MNPI and managing conflicts. This included a review of the controls to manage the interaction between research, corporate advisory and other parts of the firm—particularly research teams' involvement in capital market transactions. The review also examined information barriers, wall-crossing procedures, internal structures and reporting lines. Information was sought on the origins of corporate advisory transactions, decisions around initiation and cessation of research coverage, the relationship between research and corporate advisory transactions, and staff and principal trading in companies where the firm had a corporate advisory relationship or provided research coverage. We also met with a number of independent corporate advisers and two independent research providers.
Transaction review	We examined four transactions to see how market practice is applied. This included a large IPO (market capitalisation above $500 million), a small IPO (market capitalisation below $500 million), a placement and a sizeable block trade. The issues we observed from these transactions may also be applicable to other transaction types, including public company takeovers, mergers and acquisitions, rights issues and debt capital markets transactions. Our review focused on: • the identification and handling of MNPI received by a firm during the transaction; • the interaction between the corporate advisory and research teams (before and after the transaction mandate was signed); • how decisions around valuation of the corporate issuer were made and who was involved in this process; • which teams were involved in pitching for the mandate and their interaction with the corporate issuer; • the role of the research team in marketing the transaction to potential investors, including the use of 'investor education' research; • the process for initiating research coverage and changes to research recommendations or price targets; • how messages about the status of the transaction were communicated to investors during the marketing or bookbuild period; and • how shares were allocated to investors and how any staff and principal bids for shares were handled.

B Identification and handling of material, non-public information

Key points

Our review found that most firms have policies and procedures for handling MNPI. However, we observed that the implementation and supervision of these policies was varied and, in some instances, appropriate policies and procedures were not in place or were being ignored.

This section outlines our findings and provides commentary on the better practices we observed that firms can adopt to meet their regulatory obligations.

Background

32 Firms regularly come into contact with MNPI because of the nature of their business and the people and entities they interact with. Information may be provided to research analysts, corporate advisory and sales.

33 Research analysts interact with a range of parties, including listed companies, third parties (e.g. investors and media) and other (non-research) areas of their firm. These interactions pose risks for the research analyst in receiving or passing on MNPI.

34 Firms may seek to use or release information quickly for competitive advantage. The speed at which this occurs increases the risk that sufficient care is not taken to ensure the information is publicly available.

35 A clear understanding of what constitutes MNPI is fundamental to its identification. We found that a number of firms do not:

(a) provide sufficient training or guidance to staff about what constitutes MNPI; or

(b) employ staff that may not have the requisite experience to assess the nature of the information.

36 This presents a particular challenge for research analysts who frequently communicate with companies and may have to make the initial decision on whether information is MNPI.

37 Interactions occur between corporate advisory and research analysts at the morning research meeting, at general updates provided by corporates (for example, results presentations), sector updates provided by research, and site visits. On occasion, a research analyst or a sales person may be wall-crossed to allow them to work on a corporate advisory transaction—although this would typically only occur a day or two before the transaction is announced.

38 Where interactions occur between research and other parts of the firm, care should be taken to ensure that MNPI is not discussed and pressure is not placed on the research analyst about coverage or their recommendation on a company. If a research analyst becomes aware of MNPI they should follow the firm's wall-crossing procedure.

39 Where MNPI is mishandled there is a high risk that inappropriate trading activity, including insider trading, may occur. Firms are required to notify ASIC if they have reasonable grounds to suspect a person has placed an order or entered into a transaction while in possession of inside information, or which has the effect of creating or maintaining an artificial price, or a false or misleading appearance in the market or price for trading in financial products: see Rule 5.11.1 of the ASIC Market Integrity Rules (ASX Market) 2010, ASIC Market Integrity Rules (Chi-X Australia Market) 2011 and ASIC Market Integrity Rules (APX Market) 2013 (ASIC Market Integrity Rules (ASX), (Chi-X) and (APX)).

> Note: Firms should also refer to Regulatory Guide 238 *Suspicious activity reporting* (RG 238) and consider their obligations to self-report breaches of financial services laws to ASIC under s912D of the Corporations Act.

Selective briefings

40 Communications between listed companies and research analysts can be a useful supplement to formal market announcements and can improve the market's understanding of information concerning listed companies.

41 If the information provided contains MNPI (and is not just supplementary to information that has been publicly disclosed) it can threaten market integrity. Where companies engage in selective briefings and disclose MNPI to only a portion of the market, it creates opportunities for insider trading and undermines other investors' confidence in the market as a level playing field. It may also compromise the outcome of corporate transactions: see REP 393 for further information.

42 Disclosure by listed entities in communications must comply with the laws on continuous disclosure and insider trading.

Wall-crossing practices

43 Robust information barriers can protect the objectivity and independence of the research process and assist firms to manage conflicts.

44 Wall-crossing practices provide a mechanism for staff that have received or are provided with MNPI to be 'wall-crossed' or brought over to the private (or non-public) side of the business. Restrictions are then placed on the staff

member's use of the MNPI to minimise the risk that it is not inappropriately passed to others or acted on. These arrangements are only effective if they are in place, followed and monitored.

Note: Rule 3.6.3 of the ASIC Market Integrity Rules (ASX), (Chi-X) and (APX) provides an exception to allow advice to be provided to clients where Chinese walls (i.e. information barriers) are in place and the adviser providing the advice is not in possession of inside information. Section 1043F of the Corporations Act also provides an exception to the insider trading prohibition where a body corporate has effective Chinese wall (i.e. information barrier) arrangements in place.

Key findings

45 We identified instances of research analysts receiving information from listed companies, and passing the information to the public (trading) side of the firm without first assessing whether it was MNPI.

46 Information is communicated using a range of methods, including research reports, flash notes, internal chat messages, email or in person (e.g. at the morning sales meeting). Most firms have compliance and approval checks for research reports; however, we observed that the other forms of communication are usually not subject to the same approval or checking process. This increases the risk that MNPI may be disseminated through these channels.

47 We saw instances where MNPI would have been identified had an effective compliance, monitoring and supervisory framework been in place. This would have allowed a firm to take appropriate steps to escalate the matter to effectively manage the situation.

48 We observed that large firms had controls in place to restrict interactions between corporate advisory and research. These typically include communication blocks, physical separation and review of some or all communications (including meetings) by compliance. These restrictions were more apparent among firms with parent entities in the United States.

Note: Compliance can include an equivalent independent control function.

49 Most mid-sized firms had controls to limit interactions between corporate advisory and research, including physical and technological separation and the use of information barriers.

50 Firms that did not have adequate separation between research, sales and corporate advisory work, sought to rely on frequent wall-crossings and the use of restricted lists. We observed mixed practices in how these arrangements were being implemented and monitored by compliance. In one instance, we saw staff members added to a wall-crossing register without their knowledge. We are also aware of instances of corporate advisory staff by-passing internal controls in their communications with research analysts.

51 We identified instances of corporate advisory staff being provided with access to research analyst models—and corporate and institutional clients being able

to request research analyst models. Market practice was mixed on whether the research analyst knew that their models had been requested, the identity of the requestor and whether follow-up questions were permitted. In some firms this process is managed by the compliance team who use a range of practices to reduce the risk of the research analyst becoming aware of why the model(s) has been requested, which may constitute MNPI. These may include asking a research analyst for models for a number of companies, redacting certain information from the models provided, and not revealing the identity of who has requested the models or that the models have been requested.

52 Even where policies and procedures are in place, we observed instances where appropriate action was not taken when MNPI was received (e.g. there was no referral to compliance or use of wall-crossings). This may be due to a lack of understanding by staff of the nature of the information or whether it has been previously disclosed to the market. For example, some firms used supervisory analysts to review research without the proper training to check for conflicts, or without allocating sufficient time to review the research.

Better practices

B1 We encourage firms to have in place:

(a) policies, procedures and training on the identification and handling of MNPI, including clear escalation paths for staff that identify MNPI;

(b) effective physical and technological segregation between research, sales and corporate advisory staff. Firms may consider controls on electronic communications between research, sales and corporate advisory staff;

(c) a process for checking whether information is MNPI before its release (e.g. checking market announcement platforms, company websites and, where appropriate, asking the company to identify where the information has been disclosed publicly);

(d) approval and review processes for research that extends to all types of research and marketing material, including research reports, desk notes and flash notes;

(e) a supervisory analyst or internal review committee to review material changes to research, including an assessment of the information and factors taken into account in making the change;

(f) a process that allows sufficient time for the supervisory analyst or internal review committee to undertake an appropriate review;

(g) a process to identify whether or not a research analyst has attended a briefing with a company, particularly to ensure there is monitoring of briefings where changes to recommendations or price are made outside of a corresponding market announcement by the company;

(h) a declaration or certification from the research analyst (to compliance or a suitable supervisor) that they are not in receipt of MNPI relating to the research report, or other communication;

(i) processes to deal with requests for research analyst models. We would expect these to include compliance involvement in:

- (i) managing requests;
- (ii) reviewing the models to be provided to see if information should be redacted; and
- (iii) requesting a number of models from the research analyst and not revealing the identity of who has requested the models,

(j) a policy to limit interactions between research analysts and staff from the firm's corporate advisory team because of the high risk of MNPI being discussed or conflicts arising. This would extend to interactions such as client entertaining, conferences and investor roadshows;

(k) processes to document and retain records of meetings between staff on the public side of the firm and corporate clients or staff from the non-public side of the firm where MNPI may be discussed;

(l) monitoring of communications between research, sales and corporate advisory teams by compliance. What is reasonable will depend on the nature, scale and complexity of the business;

(m) effective monitoring and supervision by compliance of how the policies and procedures are being followed;

(n) effective arrangements (managed by compliance) for the wall-crossing of staff who receive MNPI. Firms should use a wall-crossing register and undertake appropriate monitoring activities to meet their regulatory obligations; and

(o) a process where staff acknowledge, in writing, that they have been wall-crossed and provided with guidance about what they can do in the period leading up to the MNPI becoming public.

C Management of conflicts

Key points

Our review found that most firms have policies and procedures for managing conflicts. However, we observed that the implementation and supervision of these policies was varied and, in some instances, appropriate policies and procedures were not in place or were being ignored.

This section outlines our findings on how firms manage conflicts, and provides commentary on the better practices we observed that firms can adopt to meet their regulatory obligations in the following areas:

- the structure and funding of research;
- pressure for coverage;
- research involvement in corporate transactions, including 'pitching' (pre-mandate) and 'marketing' (post-mandate);
- joint lead manager research;
- disclosure of conflicts in research notes;
- research providing 'de facto' forecasts;
- staff and principal trading;
- share allocations in capital raising transactions; and
- 'Director clubs'.

Structure and funding of research

53 The structure and funding of research teams may result in a lack of research independence. For example, the quality and independence of the research team may be compromised where:

(a) research funding is linked to corporate advisory revenues; or

(b) individual research analyst bonuses are linked to their contribution to securing capital raising mandates or marketing transactions to potential investors.

54 With declining sales commissions, it is increasingly difficult for some firms to support their research team from sales revenues. Our review found that the corporate advisory departments of large firms typically subsidise between 30–50% of research teams' costs. Although we did not obtain specific data, we expect subsidisation is even higher in mid-sized firms.

55 To obtain a return on their investment in research, firms look for synergies between their research, sales and corporate advisory teams. This may generate conflicts between the interests of the firm and their corporate clients, and the interests of investing clients in receiving unbiased research. Conflicts, whether actual, apparent or potential, can reduce the quality, integrity and reliability of research.

56 Knowledge of companies that are being considered for research coverage, the timing of release of initiation reports, cessation decisions and decisions to increase or reduce price targets or recommendations, may amount to MNPI or inside information: s1042A of the Corporations Act. The effect may be greater where a company has limited research coverage, or the research analyst has a strong investor following or history of moving the market through their research.

57 The structure of control functions is also an important element in managing conflicts. Risks areas, including wall-crossings, restricted lists and staff trading approvals, should be subject to oversight by compliance or an independent control function. If these risk areas are managed only by the front office business, the lack of independent oversight raises concerns that MNPI and conflicts may not be handled or managed appropriately.

58 Managers of research departments in larger firms can have responsibility for large teams (upwards of 50 staff), which produce a significant volume of research (as many as 5,000 items annually, including desk notes). Firms need to ensure that research managers have sufficient resources and capacity to adequately perform their role, including compliance with their firm's controls and processes. This can be more challenging where the manager also acts as a publishing analyst.

Key findings

59 Our review found:

(a) instances of a lack of understanding by staff of the firm's policies, and inadequate staff training on the internal process, for ensuring research independence;

(b) instances of inadequate separation (both physical and technological) of research, sales and corporate advisory teams, particularly within mid-sized firms;

(c) instances of staff with senior roles in mid-sized firms (who may hold shares in a company being considered for research coverage) being aware of, involved in, or seeking to influence research decisions;

(d) an instance in a large firm where a client and corporate advisory staff were made aware that a research opinion was to be changed before its publication;

(e) examples of poor internal structures and reporting lines that may make it difficult to adequately manage conflicts. For example, it is common in mid-sized firms for research analysts to report to the firm's CEO or Managing Director who is often involved in decisions about research coverage or corporate advisory work; and

(f) instances with mid-sized firms where research reports on a company were authored by the corporate advisory team that advised the company on a capital raising transaction or had an ongoing corporate advisory mandate.

60 We also found instances of remuneration structures where:

(a) research remuneration decisions, including discretionary bonuses, took into account research analyst involvement in marketing corporate transactions;

(b) research department budgets were being subsidised by corporate advisory revenues;

(c) 'investor education' roadshow expenses, including overseas travel, were being funded by corporate issuers;

(d) staff from the public side of a firm's business were encouraged and rewarded for seeking capital raising mandates; and

(e) undisclosed payments or incentives were offered by corporate issuers or their representatives directly to staff of mid-sized firms in exchange for securing the services of the firm to undertake a capital raising transaction.

Better practices

C1 Our expectations are set out in our regulatory guides: see paragraph 3, note 2. An appropriate structure will depend on the nature, scale and complexity of the business.

Better practices include:

(a) taking reasonable steps to ensure conflicts:

  (i) do not compromise the integrity of the advice firms give in their research reports;

  (ii) do not result in the AFS licensee breaching its duties, including (but not limited to) the duty to act efficiently, honestly and fairly; and

  (iii) are adequately disclosed,

(b) effective physical and technological barriers between research staff and staff performing corporate advisory or sales functions. This may include research staff not being supervised by staff from other functions that have a conflict;

(c) restricting information about initiation and cessation of research, changes to recommendations or unpublished price targets to the research team. In addition, any non-research staff member made aware of this information should follow robust wall-crossing procedures, including restrictions on using or passing on the information;

(d) decisions about remuneration of research staff not being made by corporate advisory or other staff with a conflict, and not taking into account any specific corporate advisory transaction;

(e) clearly documented compliance arrangements and measures that are communicated to staff and monitored and supervised by compliance; and

(f) adequate training on research independence policies and processes for staff involved in the preparation or review of research and corporate advisory staff.

We encourage firms to consider whether their remuneration structures incentivise public-side employees (including research analysts and sales) to seek out or discuss corporate advisory matters with listed companies. Where public-side staff come into contact with MNPI they should follow appropriate processes (e.g. advise their compliance staff and be wall-crossed).

Pressure for favourable coverage

61 Research report providers should ensure research reports are based on objective, verifiable facts and analysis, and not on the special interests of their firm, themselves or their colleagues, the corporate issuer or others. Research reports that are not based on reasonable grounds may be misleading or deceptive or result in false or misleading representations: s1041H of the Corporations Act and s12DA and 12DB of the ASIC Act.

62 We were advised by firms that the expectation of after-market support (including research coverage) is an important factor in companies awarding capital raising mandates. In addition, where a company engages an independent corporate adviser, this adviser may also seek to influence a firm's decision regarding research coverage.

63 If firms allow research staff to meet or communicate with a corporate issuer or its advisers before a firm is mandated, there is a high risk that the corporate issuer (or their advisers) may seek comfort from the research analyst that they will be supportive of a transaction.

64 This may result in coverage decisions and valuations being compromised, which can result in poorer outcomes for investors and potentially mislead the market.

Key findings

65 We observed some instances of firms' corporate advisory staff seeking to influence their research team to cover particular companies or to adjust their approach to valuation. For example, seeking to influence the selection of the industry peer group for comparable valuation purposes, or the profit margins used in preparing prospective financial information in a research report. This may help a firm to secure a corporate advisory mandate, increase the price achieved in a capital raising transaction, secure a discretionary incentive fee, or support the value of shares held by staff in the company the subject of the report.

Note: On occasion, capital raising mandates include the ability for the issuing company to pay a discretionary incentive fee to the firm managing the transaction. When used, the incentive fee is determined following completion of the transaction and after the release of any 'investor education' research. This fee can place additional pressure on the firm to ensure its research analyst delivers a report consistent with the corporate issuer's expectations.

66 As part of our review we also identified the following:

(a) policies of some large firms permit corporate advisory staff to advise corporate issuers that, while they cannot commit to provide research if awarded a mandate, it is nevertheless 'firm policy' to provide research on entities that the firm has raised capital for;

(b) mandate letters for capital raisings managed by mid-sized firms that included an obligation on the firm to initiate research coverage following completion of the transaction;

(c) firms providing drafts of research (including 'investor education' research) that included valuation information and opinions to their corporate advisory team and the corporate issuer (and its adviser), before publication;

(d) a firm advising a client that research relating to it was to be changed before the amended research was published; and

(e) an instance where a research analyst who had been wall-crossed produced conflicted research that the firm published.

Better practices

C2 Decisions regarding research coverage should be made by the research team and not subject to influence from other parts of the firm or from corporate issuers and their advisers. Firms should also have appropriate monitoring and supervision of research coverage decisions.

When 'pitching' for corporate advisory work (or in any resulting mandate agreement), corporate advisory should not express or imply that the firm will initiate research.

Research analysts should only provide draft research reports to persons outside the research department for fact checking. These reports should not contain financial forecasts, valuation information, price targets, recommendations, opinions, information that is not public or, in the case of an IPO, information that is not included in the prospectus.

Corporate issuers and their advisers should limit their review to fact checking and not provide feedback on valuations, price targets, recommendations or opinions to research analysts.

Research involvement in corporate transactions

67 The objectivity and independence of a research analyst may be compromised at various points in the process of a corporate transaction. An overview of some of the steps in an IPO and a placement, along with some areas of potential conflict, is provided in Appendix 4 for illustrative purposes only. For IPOs, a distinction is made between activities that occur:

(a) *Pre-mandate*: Before awarding the mandate (for managing or underwriting the IPO) the corporate issuer usually releases a 'request for proposal' and interviews potential lead managers. Shortlisted corporate advisory teams then typically meet with the corporate issuer.

Some firms involve their research analysts in these meetings or in broader communications with the corporate issuer.

(b) *Post-mandate*: After awarding the mandate a prospectus is prepared. The research analyst(s) of the lead manager(s) may be involved in marketing the deal or providing 'investor education' to potential investors.

68 As a result of the conflicts that can arise with corporate transactions, a research analyst's view on valuation may be compromised. This can result in poorer outcomes for investors and potentially mislead the market.

69 We are concerned that, where only a select number of investors receive 'investor education' research, they may be in receipt of MNPI once the subject of the report is listed. In particular, there are risks where there is a close and predictable correlation between valuations ascribed to a corporate issuer in a research analyst's post-IPO initiating coverage and the research analyst's earlier 'investor education'.

70 We were advised that some large firms, particularly those owned by US entities, only allow research analysts to interact with corporate advisory through compliance or an alternative control function. Some communications can only be sent between these areas by first going through compliance (as an intermediary) or, if there is a phone call or meeting, compliance attend to chaperone.

Key findings

Research involvement in *pitching* for transactions

71 We found instances of:

(a) research analyst involvement in IPO pitches, including providing valuation opinions and attending pitch meetings with or immediately after their corporate advisory team;

(b) one firm's research analyst working with its corporate advisory team to develop a view on a corporate issuer's value before a pitch was made;

(c) an implicit or explicit promise to corporate issuers that research coverage will be provided; and

(d) an increasing reliance by corporate issuers on independent advisers to assist in the selection (and oversight) of large investment banks as offering managers. We observed one instance where an independent adviser communicated an expectation, before the award of an IPO mandate, that the mandated firms' research analysts would provide research, assist in marketing the offering, and share unredacted research with the corporate issuer and the independent adviser before the research was published. The independent adviser also required the mandated firms to explain their policies and procedures should a research analyst's research 'not be supportive of the IPO for valuation, timing or other issues'.

Research involvement in *marketing* transactions

72 We found that it is common for research analysts to be involved in marketing transactions their firms are advising on though the preparation and distribution of 'investor education' research. This research is typically prepared before a prospectus is lodged with ASIC and is made available to potential institutional investors. The research analyst would then usually meet with investors in both domestic and international roadshows (with expenses reimbursed by the corporate issuer). For example, in one transaction research analysts from the mandated firms met with approximately 320 potential investors across four continents. Many of these presentations were to groups of potential investors. This requires a significant time commitment from research analysts.

73 Potential investors may benefit from 'investor education' because it can provide information on a company or sector they are not familiar with. 'Investor education' may also provide potential investors with an indication of the research analyst's approach to valuation and likely (post-IPO) initiation research valuation.

74 Price per share targets are not usually included in 'investor education' research, but a valuation range or other valuation information may be included. For example, cash flow valuations and valuation metrics based on the market pricing of comparable entities to the issuer.

Note: Section 710 of the Corporations Act sets out the requirements for the prospectus to contain all information that investors and their professional advisers would reasonably require to make an informed assessment of the offer. 'Investor education' research should be consistent with the information contained in the prospectus.

75 We found that firms with key roles in IPOs generally initiate research coverage with a recommendation of 'buy' or above.

76 Investors who have received 'investor education' research appear to be advantaged over other potential investors because they are given an indication of the research analyst's approach to valuation and an indicative valuation range. This may provide a guide of the likely price target to be contained in the research initiation report released following the listing. For example, we observed some instances where the research initiation report was identical to, or at the mid-point of, the valuation range set out in the 'investor education' research used during marketing of the IPO.

77 We also identified instances of research analysts passing on feedback from investors (obtained through the 'investor education' process) to their corporate advisory team to use in pre-bookbuild pricing deliberations. Institutional investors that participated in the 'investor education' meetings and provided feedback may receive priority or favourable treatment in the eventual share allocation process.

78 All of the large firms we met had a blackout period following IPOs where no research recommendation could be released following the listing of the company. A number of the mid-sized firms also observed a blackout period, but this was not always the case.

79 We propose to consult with industry regarding the role and appropriateness of 'investor education' as we consider proposed guidance to ensure that good research practices are followed.

Better practices

C3 We encourage firms to restrict research analyst involvement in pitching for corporate advisory mandates. This may involve restricting research analysts from meeting or communicating with a corporate issuer (or its advisers) before the award of a mandate. The potential conflict and risk to the objectivity and independence of the research is very difficult to control adequately and should be avoided.

Firms should not commit to provide research coverage (either explicitly or implicitly) for an issuer where the firm is currently mandated on a corporate transaction or where the firm is seeking a mandate.

We encourage compliance to be involved in monitoring 'investor education' research. This may include:

(a) reviewing and maintaining records of communications between the research analyst and the corporate issuer when preparing 'investor education';

(b) chaperoning meetings between research analysts and corporate issuers on 'investor education' research;

(c) blocking or periodically monitoring the communications of research analysts and corporate advisory staff to ensure research independence is not being undermined;

(d) reviewing 'investor education' research to make sure it does not include information that is not:

  (i) contained in the prospectus;

  (ii) not otherwise publicly available; and

  Note: All information an investor would reasonably require must be in the prospectus, see s710 of the Corporations Act.

  (iii) tipping-off potential investors about the price target to be contained in the subsequent initiating research report; and

(e) including appropriate disclosure in 'investor education' research of conflicts: see paragraphs 91–98.

Joint lead manager research

80 A common structure used for larger capital raising transactions (in particular IPOs) is for corporate issuers to mandate a number of firms to act as joint lead managers (JLMs) to the issue.

81 Where JLMs are mandated to undertake an IPO, it is common for research guidelines or protocols to be adopted covering the content, preparation and publication of JLM research.

82 The research analysts from each of the JLMs usually meet to receive a joint briefing from the corporate issuer. The purpose of the meeting is to provide a detailed overview of the corporate issuer at one time to all JLM research

analysts. The meeting can also form part of each JLM's due diligence process for the IPO. Sales and corporate advisory staff may be present at these meetings.

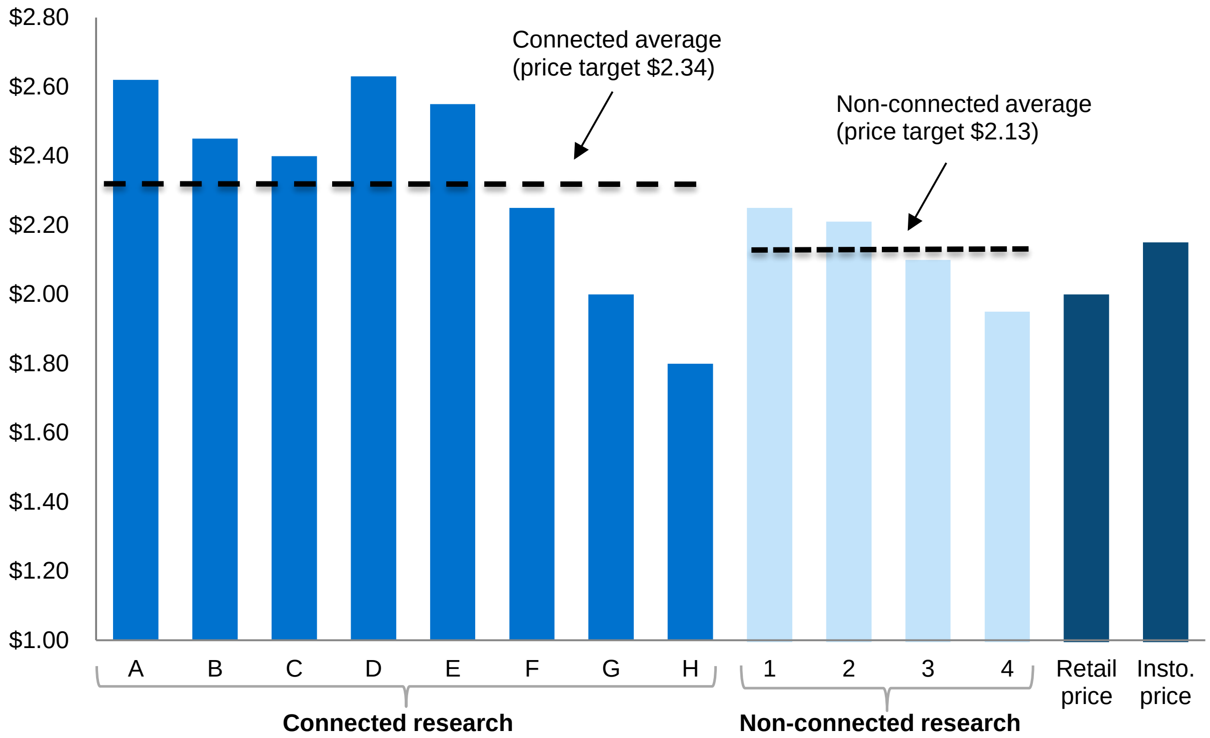
83 There is a risk that research analysts in these meetings will be influenced by the corporate issuer (or their advisers) or the other research analysts, and may receive company information that is not subsequently included in the prospectus. This can create a risk of the independence of research becoming compromised, and may lead to the market being misled.

84 We undertook an analysis of price targets included in research reports published for a range of IPO transactions from January 2014 until December 2015. We split the research reports into connected research (i.e. firms who were named in the prospectus) and non-connected research (i.e. firms not named in the prospectus).

85 From the data available it was difficult to draw any significant conclusions and, on average, we did not observe a noticeable difference between connected and non-connected research. However, in our sample the number of non-connected research reports for most companies was low (at just one or two).

86 When we looked at a transaction with a larger number of non-connected research reports we observed a different outcome. An analysis of research released after the IPO of Medibank Private Limited in November 2014 showed that the average price target for connected research was around 10% higher than for non-connected research: see Figure 1.

Figure 1: Medibank Private Limited—research price targets post IPO



Key findings

87 We observed a situation where the corporate advisory teams of the JLMs engaged in an IPO agreed to a common approach on how to value the corporate issuer. Some of these JLMs then sought to influence their respective research analysts to adopt this approach to valuation.

88 We observed a situation where JLM research analysts agreed to include financial forecasts in ‘investor education’ research that went beyond the forecast period to be included in the prospectus.

89 We saw an instance of JLMs developing guidelines that provided for the JLM research analysts to share their research with the corporate issuer before its publication. However, we did not find examples of collusion between JLM research analysts on indicative valuations.

90 We also observed instances of JLM research analysts not following the agreed research report guidelines.

Better practices

C4 We encourage JLMs to:

(a) prevent their research analysts from discussing their approach to valuation or indicative valuation ranges with their corporate advisory team, the corporate issuer (or its advisers) or with other JLM research analysts; and

(b) invite non-connected research analysts to pre-listing company briefings to ensure that research analysts are similarly informed and reduce the risk of selective briefings.

Note: See also paragraphs 67–79.

Disclosure of conflicts

91 Conflicts, whether real or potential, may adversely affect the independence and reliability of research reports. If these conflicts are too difficult to manage they should be avoided.

92 Where conflicts arise, it is important that firms’ research reports accurately disclose them so that users of those reports can have confidence in the integrity of the research and decide how much reliance they should place on it.

93 AFS licensees are required to have in place adequate arrangements for the management of conflicts that arise in relation to their activities: s912A(1)(aa) of the Corporations Act. Existing guidance also sets out our expectations that disclosure of conflicts should be specific, clear and meaningful: see RG 79 and RG 181.

94 Disclosure of conflicts should be managed by a compliance team with access to information about the business so they are aware of the full range of conflicts that should be disclosed.

Key findings

95 We observed instances of mixed practices in relation to the quality of disclosures made by firms in their research reports and other publications. Most contained boilerplate information and generic wording that staff may hold shares or the firm may seek corporate work from the issuer of the report. Some firms provide specific, meaningful and clear disclosures of interests on the front page of research reports.

96 There were varying practices surrounding the disclosure of personal holdings, which were typically limited to the author of the research. We observed that other people within firms were also aware of, or may have influence over, pending research decisions. For example, the research manager, other research analysts, senior management of the firm and staff from other areas of the firm. We observed one mid-sized firm where disclosure of these shareholdings was included in a research report. However, this information is usually not included.

97 One large firm repeatedly failed to disclose conflicting advisory mandates in research, citing human error. While another large firm was working with a listed company on a publicly announced takeover—for which a formal mandate letter had not been entered—and released a research report on the company without adequate disclosure of the firm's corporate advisory role.

98 We also noted that while all large firms had policies on the independence of research, most did not publish these on the firm's website.

Better practices

C5 We expect firms to:

(a) adopt an appropriate business model and ensure the firm is structured to minimise and manage real and potential conflicts associated with internal research processes;

(b) have adequate controls in place to manage conflicts, including avoiding conflicts that cannot otherwise be managed; and

(c) give meaningful disclosure to help users of the research understand any conflicts, how they are managed, and the extent to which they can rely on the research.

The disclosure set out in each research report should include prominent, specific and meaningful information about a firm's conflicts, including:

(a) any material interests they (or any associated persons) have in financial products that are the subject of the report;

(b) any benefits (including reimbursed expenses and entertainment) they are likely to receive from the company the subject of the report;

(c) their relationship (if any) to the company the subject of the report, including any other services they provide to the company;

(d) any assistance provided by the company the subject of the report in preparing the report (e.g. whether the research analyst attended a site visit);

(e) the date the research report was written and who took responsibility for it; and

(f) the reasons behind the opinions and recommendations in the research report.

We encourage firms to extend disclosure of interests to include other people within the firm who have involvement in, or knowledge of, research decisions.

We also encourage firms to make available, on the firm's website, their policy in relation to research independence.

Disclosure of conflicts should be subject to internal compliance controls and monitoring.

Prospective financial information and securities recommendations

99 A company should not include prospective financial information in a prospectus or control transaction disclosure document unless they have reasonable grounds for its inclusion.

100 We are concerned where connected firms (i.e. firms who have been or continue to be involved with the company the subject of a capital raising or control transaction) release research reports containing prospective financial information within a short period following a capital raising that was not included in the prospectus.

101 We are also concerned where connected firms release material changes to research recommendations preceding a capital raising or control transaction. These firms need to have reasonable grounds for the content of their reports.

Key findings

102 We observed a situation where a prospectus for an IPO did not contain any prospective financial information because the directors stated they did not believe they had reasonable grounds for their inclusion. Shortly after the listing, the firm that acted as lead manager to the IPO released a research report that contained prospective financial information. The company the subject of the report then released the report on its website and on the ASX market announcement platform.

Better practices

C6 Firms should not use research reports as a 'de facto' mechanism to release prospective financial information, including securities 'buy' recommendations, to the market outside of the legal and regulatory requirements in relation to the prospectus, control transaction and continuous disclosure regimes. Firms should be aware of the prohibition on misleading and deceptive conduct: s1041H Corporations Act.

Companies should consider their legal and regulatory requirements before releasing research reports that contain securities 'buy' recommendations to the ASX market announcement platform.

The requirement to have reasonable grounds for prospective financial information extends to firms providing research reports on companies' financial forecasts and reports containing securities 'buy' recommendations.

Note: See Regulatory Guide 170 *Prospective financial information* (RG 170), Regulatory Guide 111 *Content of expert reports* (RG 111), Information Sheet 214 *Mining and resources: Forward-looking statements* (INFO 214), and the provisions of the Corporations Act referred to in these guides.

Staff and principal trading

103 Staff and principal trading is a high-risk area for poor management of conflicts and mishandling of MNPI.

104 Report 452 *Review of high-frequency trading and dark liquidity* (REP 452) noted that market participants need to be mindful of the potential for insider trading and market manipulation if they trade when in the receipt of MNPI regarding client orders or trading intentions.

105 Staff and principal trading has the potential to influence business decisions, research recommendations and corporate advice if staff and principal interests take priority over client interests.

Key findings

106 We observed high levels of staff trading among the majority of mid-sized firms in our review. These firms typically allow staff to participate in capital raisings they were managing. In general, large firms did not allow staff to participate in capital raising transactions they were managing.

107 In mid-sized firms we identified:

(a) instances of staff participating in transactions and IPOs that struggle to attract investors to assist in meeting the shareholder spread requirements;

(b) instances of client bids being scaled back in well-supported capital raising transactions to allow for staff participation. In one instance, an IPO that was heavily oversubscribed saw client bids being scaled back to allow for the firm’s staff to receive an allocation of approximately 10% of the amount being raised in the transaction;

(c) an instance of staff marketing research on companies to clients with a ‘buy’ recommendation while concurrently selling their personal shareholdings in the company; and

(d) instances of companies being selected by firms for research coverage or corporate business, when senior staff at the firms held shares in the companies. This can increase the risk of market manipulation such as ‘pump and dump’ strategies.

Note: A ‘pump and dump’ occurs where the firm or its staff acquire shares in a company (typically a small capitalisation company with little if any earnings). The firm then promotes the company to its clients through overly optimistic research and marketing by the sales desk (the ‘pump’). The firm or its staff then start to sell the shares at prices well below the research price target (the ‘dump’). This usually results in the shares declining in value and investors left holding shares of little value.

108 We observed a range of practices in relation to minimum hold periods for staff trading. Most firms had some form of minimum hold period. For secondary market trading this ranged from one day to 30 days; and for capital raising transactions this was typically 30 days. One firm adopted a 15 day minimum hold period for all types of staff trading and, concerningly, some mid-sized firms had no minimum hold periods.

109 We found varying internal approval processes for staff orders. This may comprise orders being submitted through an electronic order system or recorded in a physical order book. Staff orders are typically sent to a senior member in the staff member’s team, or to the compliance team, for approval.

110 Some mid-sized firms have poor or non-existent practices for the approval and monitoring of staff trading. We found instances of staff with knowledge of research coverage decisions and authors of research reports trading ahead of, or contrary to, their research recommendations.

Note: Market participants are also required to maintain records of dealing on their own account (see Rule 4.1.2 of the ASIC Market Integrity Rules (ASX), (Chi-X) and (APX)) and trading by connected persons requires internal consent: see Rule 5.4.2 of the ASIC Market Integrity Rules (ASX), (Chi-X) and (APX).

111 We saw an instance of staff trading requests at a mid-sized firm being approved by people sitting outside the staff member’s team. This raises concerns that the person approving the trade may not be in possession of all relevant information when making a decision about whether the trade should be allowed. Compliance, or an equivalent control function, should also review trades to check the company is not on the internal restricted list or that the staff member has not been wall-crossed for the company.

Better practices

C7 Firms should consider whether the potential conflict from staff and principal trading is too great to be managed or controlled and should be avoided.

Consideration should also be given to:

(a) appropriate blackout periods for staff trading before and after the initiation of research, following material changes in research recommendations or price targets, and around capital raising transactions the firm is involved in. This will allow the information to be communicated to clients and provide them with time to make an investment decision before any staff or principal trading;

(b) restricting research analysts and other staff members who are involved in research decisions from trading contrary to the firm's published research recommendations;

(c) appropriate minimum holding periods for staff trading;

(d) robust approval processes when staff and principal trading occurs. Staff designated to approve staff and principal transactions should be aware of the potential conflicts and what MNPI the firm and individuals hold; and

(e) requiring compliance (or a similar control function) to monitor staff trading, including enforcement of blackouts, minimum hold periods and restricted lists.

Share allocations in capital raising transactions

112 Firms engaged to manage capital raising transactions seek bids from potential investors. One of the roles of the firm managing the transaction is to recommend to the corporate issuer how these bids should be allocated to investors.

113 In the course of our review, we identified allocation practices firms have adopted that may create potential issues for the handling of MNPI and conflicts.

114 We also noted that, during the marketing of some capital raising transactions, firms usually provide an update on the status of the raising to potential investors. When bids for shares for more than the amount being raised have been received, it is common for firms to advise potential investors that the issue is 'covered'. We understand investors look for this message because it provides an indication that a transaction will proceed and may encourage potential investors to submit bids or increase their bids in the expectation they may be scaled back in the allocation process.

115 When providing messages to potential investors about to the status of a capital transaction, firms should take care not to engage in misleading and deceptive conduct or make false and misleading statements: s1041H of the Corporations Act and s12DA and 12DB of the ASIC Act.

Key findings

116 Most firms have allocation policies setting out a range of criteria that are considered when allocating shares in capital raising transactions they are managing.

117 The allocation policies are used as guidelines and are subject to the discretion of the firm. Factors taken into account in making allocation decisions include:

(a) the timing and receipt of bids;

(b) whether the bid is genuine and the capacity of the investor to settle the amount bid for;

(c) the investor's level of interest in the company and sector, and engagement with the firm;

(d) any legal or regulatory restrictions on the investor's participation;

(e) the expectations and requirements of the corporate issuer; and

(f) the treatment of bids from principal, staff and related accounts.

118 In addition to the allocation policies described above, for IPOs the prospectus will typically include information on the criteria the corporate issuer will apply in allocating shares applied for under the offer.

119 When we looked at transactions, we observed:

(a) for institutional investors, larger allocations being provided to the firm's most valuable clients (i.e. clients who pay the most commission or regularly support the firm's transactions);

(b) differential treatment of clients based on how they have been classified by firms. We saw an instance where hedge funds that placed bids for shares in a transaction received significantly larger scale backs than other investors;

(c) instances of larger allocations in an IPO being offered to investors in exchange for a commitment to engage in after-market buying in the corporate issuer or to 'make good' or compensate a client for earlier trading losses with the firm;

(d) an instance of a sizeable allocation in an IPO being provided to senior management or directors of other companies that the firm managing the IPO was seeking to secure corporate business from in the future;

(e) instances of investor bids being scaled back in favour of principal or staff allocations (see paragraph 103–111);

(f) that corporate issuers are typically provided with the proposed allocation of shares for a transaction for their approval; and

Note: We understand that companies generally have little involvement in the allocation process (other than, perhaps, querying some of the names or proposed allocations) and rely on the firm(s) involved to make a recommendation. We did, however, see an example where a corporate issuer retained a veto right over the allocation process.

(g) an instance of inconsistent and potentially misleading information provided to potential investors on the bookbuild for a secondary market sale. In particular, about the level of demand that had been received for the transaction.

Better practices

C8 Firms should implement a policy for how shares are allocated in capital raising transactions. Allocation decisions should take into account a range of factors to ensure a fair and efficient allocation process and to minimise potential conflicts.

Better practices include:

(a) discussing the approach to allocations with the corporate issuer during the course of the transaction. Corporate issuers are also encouraged to understand and be involved in the allocation process;

(b) placing client interests ahead of staff interests when assessing staff and principal participation in capital raising transactions. This may result in no staff or principal participation in transactions that have sufficient investor support;

(c) not providing investors with larger allocations on the understanding (implied or expressed) they will place buy orders in the after-market;

(d) avoiding allocations to senior executives or directors of companies that the firm is seeking to secure corporate business from; and

(e) developing clear processes and responsibilities on who can provide messaging about the status of a capital raising transaction. Firms should ensure there is a reasonable basis for any statements made, and that they are not false, misleading or deceptive.

‘Director clubs’

120 We are aware of an arrangement where a firm makes available, in their offices and for no cost or subsidised cost, office space and secretarial and administrative services to company directors (known as ‘Director clubs’).

121 Depending on the basis upon which these services are provided they may create a sense of obligation for the company director to reward the firm, and raises the potential for conflicts to arise. Along with the accessibility of the director, this may increase the risk of MNPI being passed when the director interacts with staff from the firm.

Better practices

C9 Firms who provide ‘Director clubs’ or an equivalent arrangement should assess:

(a) the purpose and appropriateness of the arrangement;

(b) what is expected from the director;

(c) what interactions between the director and staff of the firm will occur and how these are managed (e.g. this may include oversight by compliance); and

(d) physical and technological separation of the director from the firm's staff.

Directors who participate in these arrangements should consider the purpose of the arrangement and whether they should enter into it having regard to their duties: s182–183 of the Corporations Act.

Directors who decide to proceed by accepting these arrangements should, at a minimum, disclose the arrangement to the company they are a director of, and consider the appropriateness of participating in decisions about the provision of services or allocations to firms providing the services.

Appendix 1: Structure of expected controls

122 We have outlined a suggested framework of controls that largely represent the better practices set out in Sections B and C, and which firms should consider for the handling of MNPI and management of conflicts. We expect firms to consider a range of controls to better handle MNPI and manage conflicts.

Table 2: Summary of expected controls

Type of control	Examples of expected controls
Behavioural	• Training • Consistency of communications • Consequences for breaches
Structural	• Research department independence • Confidentiality of unpublished research • Restrictions on staff trading
Procedural	• Approval of research • Equal dissemination • Effective use and monitoring of information barriers
Disclosure and certification	• Policy disclosure • Research analyst disclosure of interest • Research analyst certification for MNPI • Management attestations • Meeting logs
Monitoring and review	• Vetting of communications • Periodic review of communications • Post-vetting of trading • Compliance visibility and accessibility • Resourcing of compliance • Access to records • Reporting breaches to ASIC

Behavioural

123 Behavioural controls that firms may consider include:

(a) *Training*: Induction and continuing training on the firm's rules, policies and procedures, focusing on real-world issues presented by potential conflicts or unauthorised release of MNPI. For example, the identification and handling of confidential information such as selective briefings to research analysts.

(b) *Consistency of communications*: Consistency between research analyst communications (both internal and external) and a firm's published research.

(c) *Consequences for breaches*: Meaningful consequences applied to individuals who breach internal policies and procedures. These could include adverse financial consequences, being overlooked for promotions or termination—depending on the severity and frequency of the breach.

Structural

124 Structural controls that firms may consider include:

(a) *Research department independence*: Independent reporting lines, supervision and remuneration decisions for the research department, as well as physical and technological separation from other parts of the firm.

(b) *Confidentiality of unpublished research*: Restricting information about unpublished research or proposed research decisions to within the research department until publication. This should be supported by effective segregation of duties and management, and robust information barriers.

(c) *Restrictions on staff trading*: Controls around restricting research staff, and other staff with knowledge of or involvement in research decisions, from trading contrary to published research recommendations and appropriate blackout periods before and after the release of research. Controls of this nature should also apply to other business areas, including corporate transactions.

Procedural

125 Procedural controls that firms may consider include:

(a) *Approval of research*: An internal gatekeeper process that research reports, 'investor education' and other communications (such as desk notes) with material changes to recommendations or price targets go through before being released. This process should consider the reasonableness of the change and whether the information justifying the change is MNPI by making further inquiries on the sources, if necessary. Particular attention should be given to changes made following recent meetings with the company the subject of the report.

(b) *Equal dissemination*: Disseminate research to all eligible clients simultaneously. Providing research to preferred clients ahead of other clients or flagging to certain clients that research ratings are under review would be regarded as poor practices.

(c) *Effective use and monitoring of information barriers*: Effective physical segregation and information barriers should be established between research, sales and corporate advisory staff. In addition, some firms block email and other electronic communications between research, sales and corporate advisory staff.

Disclosure and certification

126 Disclosure and certification controls that firms may consider include:

(a) *Policy disclosure*: Firms should publish the criteria they use to decide whether to provide or cease research coverage. Firms should also consider disclosing their policies on the independence of research and discussing allocation policies with corporate issuers.

(b) *Research analyst disclosure of interest*: Research report providers should prominently disclose in or with each research report whether they (or any associated persons) have, or are likely in the future to have, a material interest in financial products that are the subject of the report. This would include whether the research analyst's firm has interests that should be disclosed, for example, the firm has received fees for its involvement in a capital raising involving the company the subject of the report. Disclosure will generally need to cover both the existence and extent of the interest.

(c) *Research analyst certification for MNPI*: Disclosure by research analysts submitting a report for pre-publication approval about whether they have met with or spoken to the company the subject of the report (or its advisers) in preparing the report, and certifying that there was no reliance on MNPI in preparing the report.

(d) *Management attestations*: Periodic (annual/quarterly/semi-annual) attestation by senior research management on compliance with the firm's internal policies and procedures and relevant regulatory requirements. This should include compliance, or management review of compliance, with the internal process for research preparation and approval.

(e) *Meetings logs*: Maintain records of research analysts' meetings and communications with companies they cover or propose to cover. This should include a declaration that no MNPI was received by the research analyst during the meeting.

Monitoring and review

127 Monitoring and review controls that firms may consider include:

(a) *Vetting of communications*: Compliance monitoring of all emails and electronic messages to and from research, sales and corporate advisory. In particular, for the period before and after the release of research reports that contain a material change to the rating or price target. Firms should consider what is reasonable based on the nature, scale and complexity of their business.

(b) *Periodic review of communications:* Periodic testing of samples of emails and electronic communications between research, sales and corporate advisory, and between research and companies the subject of the research, to ensure that MNPI has not been discussed or referred to. In particular, for the period before and after the release of research reports that contain a material change to the rating or price target.

(c) *Post-vetting of trading*: Periodic testing of trading before and after the release of research, in particular, research with a material change to the rating or price target. Review of principal trading (including facilitation and market making), staff trading (including the approvals obtained) and client trading. Consideration should be given to whether client, staff or principal trading occurred before the release of a report, with a material change as an indicator of possible preferential treatment, insider trading or front-running.

(d) *Compliance visibility and accessibility*: Compliance staff should attend the main research sales meetings (typically this will be a daily morning meeting) on a periodic basis.

(e) *Resourcing of compliance*: Large firms may consider a dedicated compliance resource within the research department. This would be in addition to any supervisory analyst function and enable compliance to be on hand to field queries and check issues as they arise.

(f) *Access to records*: Providing compliance with access to records, including logs of one-on-one meetings with companies the subject of research, research analysts' calendars and notes (both electronic and hard copy), and staff trading records and approvals for monitoring and surveillance purposes.

(g) *Reporting breaches to ASIC*: See s912D of the Corporations Act and RG 78.

Appendix 2: Summary of relevant legislative provisions

Table 3: Summary of relevant provisions of the Corporations Act

AFS licensee obligations (s912A)	An AFS licensee must: • do all things necessary to ensure their financial services are provided efficiently, honestly and fairly; • comply with financial services laws and take reasonable steps to ensure their representatives do likewise; • have adequate compliance arrangements; • have adequate arrangements for the management of conflicts that may arise wholly, or partially, in relation to the provision of financial services; and • have adequate resources, be competent, and ensure that representatives are adequately trained and supervised.
Prohibition against market manipulation (s1041A)	A person must not engage in a transaction that has or is likely to have the effect of creating an artificial price for trading in financial products or maintaining a price that is artificial.
Prohibition against misleading or deceptive conduct (s1041H)	A person must not engage in conduct in relation to a financial product or a financial service that is misleading or deceptive or is likely to mislead or deceive.
Prohibition against insider trading (s1043A)	An insider who possesses inside information, and knows or should reasonably know that the information they possess is insider information, must not: • apply for, acquire or dispose of the relevant entity's financial products (or enter into an agreement or procure another person to apply for, acquire or dispose of the relevant entity's financial products); or • directly or indirectly communicate the information to another person if the insider knows or should reasonably know that the other person would acquire or dispose of (or apply for or enter into an agreement to acquire or dispose of) the relevant entity's financial products or procure another person to do so.
Exceptions to the prohibition against insider trading (s1043B–K)	Exceptions to the prohibitions against insider trading.

Table 4: Summary of relevant provisions of the ASIC Act

Misleading or deceptive conduct (s12DA)	A person must not engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive.
False or misleading representations (s12DB)	A person must not make a false or misleading representation in connection with the supply of financial services or in connection with the promotion of the supply or use of financial services.

Appendix 3: International regulatory approaches

Background

128 Australia operates under a principles-based approach to financial services regulation: see our *Statement of intent: July 2014*. Examples of this include the obligation for AFS licensees to manage conflicts and provide financial services efficiently, honestly and fairly: s912A of the Corporations Act.

129 The principles-based approach is supplemented, where appropriate, by regulatory guidance. This guidance explains how we interpret the law, describes the principles underlying our approach, and provides practical guidance to the regulated population.

130 The approach taken in Australia can be contrasted with the prescriptive approach taken by jurisdictions such as the United States. The prescriptive approach is particularly evident in how the United States regulates research.

United States

131 In 2003, the New York State Attorney General and a number of US regulatory agencies announced the settlement of enforcement actions against ten large investment banks for inappropriate influence by their investment banking personnel over research analysts, which generated conflicts of interest that were not properly disclosed or managed (the Global Settlement).

132 In addition to paying penalties, the firms agreed to make structural reforms to insulate research from inappropriate investment banking influence. The reforms covered a large range of matters, including the physical separation of research from investment banking, and the insulation of research budgets and coverage decisions from investment banking input.

133 Most of the requirements in the Global Settlement were reflected in rules adopted by the National Association Of Securities Dealers (NASD), which was merged with other self-regulatory organisations to form FINRA in 2007 (the FINRA Rules). The FINRA Rules have undergone a number of amendments since 2007. The most recent changes, including the extension to debt research, were agreed to by the SEC in July 2015: see SEC, *Release 34-75471* (PDF 200 KB).

Note: Every firm that sells securities to the public in the United States must be licensed and registered by FINRA.

134 The FINRA Rules create a stringent regulatory environment for firms and their research analysts. Under the FINRA rules, member firms must establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage any conflicts related to research reports. The policies must be designed to promote reliable and objective research that

reflects the opinion of the research analyst: FINRA Rules 2241(b)(2) and 2242(b)(2). The new FINRA Rules governing the production of debt research are similar to the equity research rules but are more liberal (in certain respects) for debt research only provided to the wholesale market: FINRA Rule 2242.

135 The FINRA Rules cover the following areas for research reports:

(a) *content and disclosure in research reports*—research reports must be based on reliable information, must disclose material conflicts, and any recommendation or price target must have a reasonable basis;

(b) *distribution of research and third-party research*—research reports must not be distributed on a selective basis to clients; and

(c) *termination of coverage*—a member firm must promptly notify its clients if it intends to terminate coverage of a company. A final research report must also be submitted, including a final recommendation or rating.

Note: The FINRA Rules are more liberal in their application to 'emerging growth companies' as defined in the *Jumpstart Our Business Startups Act (2012)* (US) (i.e. companies with gross revenues of less than USD 1 billion in their preceding fiscal year, subject to several exclusions).

136 The FINRA Rules cover the following areas in relation to identifying and managing conflicts:

(a) *compensation of research analysts*—member firms' policies must prohibit investment banking from supervising research analysts or exerting influence over their compensation;

(b) *pre-publication review*—these requirements were tightened last year to prevent any pre-publication review of research by corporate advisory staff, although client fact-checking is still permitted if the analysts' views on valuation are removed and any changes are accompanied by a written justification;

(c) *research department budget*—investment banking is expressly prohibited from providing any input into the determination of the appropriate research department budget;

(d) *blackout periods*—the FINRA Rules prohibit research analysts from making public appearances or publishing research (i.e. a quiet period) for the following:

(i) a minimum of ten days for an IPO; and

(ii) a minimum of three days for a secondary offering,

(e) *marketing and solicitation*—research analysts are prohibited from participating in pitches or other solicitation activity on behalf of corporate advisers or their transactions, or any other marketing (including participating in roadshows) on behalf of the issuer in a transaction. Pitch materials must not include details that suggests the firm would provide favourable research;

(f) *joint due diligence*—research analysts must not participate in due diligence in the presence of investment banking staff before the selection of an underwriter for a relevant transaction. However, with appropriate institutional safeguards, joint diligence sessions are permitted;

(g) *restrictions on personal trading by research analysts*—research analysts must not trade in securities, any derivatives of such securities, and any funds whose performance is materially dependent upon the performance of any securities covered by the research analyst. Research analysts may not receive pre-IPO shares in the sector they cover or trade against their recent recommendation;

(h) *anti-retaliation*—a member firm may not directly or indirectly retaliate or threaten retaliation against a research analyst as a result of any adverse research report or public appearance; and

(i) *information barriers*—a member firm's policies and procedures must establish information barriers to ensure research analysts are insulated from the review or oversight of persons engaged in investment banking services, sales and trading. The FINRA Rules also expect physical separation, except in 'extraordinary circumstances where the costs are unreasonable due to a firm's size and resources'.

137 FINRA has also indicated a continuing focus on whether member firms' research analysts are inappropriately involved in member firms' investment banking activities, and whether investment banking staff are exercising undue influence over research analysts: see FINRA, *Regulatory and examination priorities letter for 2016*.

United Kingdom

138 The Financial Conduct Authority (FCA) has published the *Conduct of Business Sourcebook*. Chapter 12 sets out specific requirements on the production and dissemination of investment research and non-independent research.

139 The regulations stipulate that research analysts are prohibited from involvement in activities that are inconsistent with the maintenance of their objectivity. The activities specified include research analyst participation in investment banking activities (e.g. corporate finance business and underwriting), participation in pitches for new business or roadshows for new issues, or being otherwise involved in the preparation of issuer marketing.

140 Other restrictions include:

(a) preventing staff and principal trading if they have knowledge of the likely timing or content of research reports;

(b) anyone involved in the production of investment research must not accept inducements from those with a material interest in the research; and

(c) issuers, or any person other than analysts reviewing research before publication, may not review research containing recommendations or a target price for any purpose (including verifying factual accuracy) except to verify compliance with the firm's legal obligations.

141 Chapter 10 of the FCA's *Senior arrangements, systems and controls* contains a number of relevant provisions on functional independence, information barriers, supervision, remuneration, inappropriate influence, and the performance of multiple conflicting services: Article 10.1.11. Article 10.1.12 notes that firms' conflicts of interest policies need to pay 'special attention' to conflicts between research and investment banking activities.

142 In December 2015, the FCA published the findings of a review into how investment banking firms manage the MNPI they receive and generate: see FCA, *Flows of confidential and inside information*, TR15/13. The review focused on the processes investment banks have in place to control flows of MNPI and sampled small to mid-sized wholesale investment banks, and integrated and purely private-side advisory houses.

Note: The report followed concerns and suggestions made in *An independent review for the Secretary of State for Business, Innovation & Skills: IPOs and bookbuilding in future HM Government primary share disposals* (PDF 834 KB), 16 December 2014.

143 While the review focused on the debt capital markets and mergers and acquisitions divisions of small to mid-sized investment banks, the key findings are relevant across all business areas.

144 The key findings were summarised under three main headings:

(a) *Circumstances posing heightened risk*: Firms should consider which circumstances pose a heightened risk for misuse of MNPI and whether these have been considered and mitigated appropriately.

(b) *Conduct, culture and responsibility*: All staff have a role to play in ensuring that flows of MNPI are adequately controlled, although ultimate responsibility sits with senior management.

(c) *Firm systems, procedures and infrastructure*: Robust systems, procedures and infrastructure underpin the effective management of flows of MNPI in firms.

145 The FCA also published a market study, *Investment and corporate banking market study: Interim report*, MS15/1.2, in April 2016. The report considered choice, universal banking and cross subsidies, and other market practices such as syndication, reciprocity, league tables, corporate finance advisers, transparency of scope of services and fees, the IPO process and allocation of shares in IPO bookbuilding. As part of this project the FCA published a discussion paper, *Availability of information in the UK equity IPO process*, DP16/3, in April 2016. The discussion paper covers issues relating to the involvement of research analysts in the IPO process and submissions and feedback on the paper have been sought.

146 The Markets in Financial Instruments Directive (MiFID) II is scheduled to take effect from 3 January 2018. Under Article 23, firms will be required to

take all appropriate steps to identify and prevent or manage conflicts. MiFID II will also significantly enhance the content and quality of the disclosure to be made available to clients when firms cannot manage or prevent conflicts from arising. MiFID II also proposes to unbundle payments for investment research from trading commissions: Article 24.

Hong Kong

147 The Securities and Futures Commission (SFC) of Hong Kong has published the *Code of conduct for persons licensed by or registered with the Securities and Futures Commission* (the SFC Code). The SFC Code was updated in 2011 following consideration of responses to the SFC's *Consultation paper on the regulatory framework for pre-deal research*, published in September 2010. The consultation paper and amendments to the SFC Code were driven by concerns that institutional investors were being provided material information (not subject to prospectus liability) in pre-deal research that was not available to retail investors: see 16.3, 16.5–16.8, 16.10–16.11 and 17.14 of the SFC code.

148 The SFC code requires firms to:

(a) have mechanisms to ensure research is not prejudiced by firm trading activities, financial interests or business relationships;

(b) ensure reporting lines for analysts and their compensation arrangements are structured to eliminate or severely limit actual or potential conflicts of interest;

(c) ensure that any undue influence of issuers, institutional investors and other outside parties on analysts is eliminated or managed; and

(d) disclose any interest greater than 1% of the market capitalisation of any issuer it provides research on.

149 The SFC code also sets out the following requirements:

(a) A firm's research analysts should not report to its investment banking function, nor should a research analyst's compensation be directly linked to any specific investment banking transaction.

(b) A firm's investment banking function should not pre-approve research analyst reports or recommendations, except (subject to oversight by compliance or legal) where it reviews a research report for factual accuracy before publication.

(c) A research analyst should not participate in soliciting investment banking business, for example, at sales pitches or deal roadshows.

(d) A firm should have controls to eliminate, avoid or manage actual and potential research analyst conflicts, appropriate to the firm and its clients.

(e) A firm should have controls to ensure that research analysts responsible for preparing a research report on a new listing applicant are not provided with any material information about the applicant that is not reasonably expected to be included in the prospectus or publicly available.

(f) An analyst should not seek from an IPO issuer or its advisers any material information, including forward-looking information (whether qualitative or quantitative), concerning the issuer that is not expected to be included in the prospectus or publicly available.

(g) A sponsor should take reasonable steps to ensure that all material information about a listing applicant disclosed to analysts is contained in the relevant listing document.

(h) A firm with an investment banking relationship with an issuer should disclose that relationship in the research report. Any fees for investment banking services received over the preceding 12 months would constitute an investment banking relationship.

International Organization of Securities Commissions (IOSCO)

150 In 2003, IOSCO published the *Statement of principles for addressing sell-side securities analyst conflicts of interest* (PDF 175 KB), which recommended that mechanisms should exist so that the following activities do not prejudice analysts' research and recommendations:

(a) analysts' trading activities or financial interests;

(b) the trading activities or financial interests of the firms that employ them; and

(c) the business relationships of the firms that employ analysts.

151 The measures outlined for ensuring that a firm's business relations do not prejudice analyst's research include robust information barriers between analysts and the firm's other divisions, and the prevention of analysts from attending sales pitches and roadshows. Other measures include the following:

(a) Reporting lines for analysts and their compensation arrangements should be structured to eliminate or severely limit actual and potential conflicts of interest.

(b) Firms that employ analysts should establish written internal procedures or controls to identify and eliminate, manage or disclose actual and potential conflicts of interest.

(c) The undue influence of issuers, institutional investors and other outside parties upon analysts should be eliminated or managed.

(d) Disclosure of actual and potential conflicts of interest should be complete, timely, clear, concise, specific and prominent.

(e) Analysts should be held to high integrity standards.

(f) Investors should be educated not to rely solely on analyst recommendations and disclosure rules, so that they can better evaluate potential biases and conflicts in analyst research.

152 IOSCO published *Guidelines for the regulation of conflicts of interest facing market intermediaries* (PDF 438 KB) in November 2010. The guidelines noted that while the regulatory framework for the management of conflicts should provide a balance between robust and 'light touch' regulation, the importance of adopting strict measures to avoid conflicts from arising was emphasised.

Appendix 4: Overview of IPOs and placements

Table 5: IPOs

Activities (including risk areas)		Potential concerns
• Pitching for a role often includes a request for proposal. • Corporate issuer may engage an independent adviser (IA). • Risk if both corporate advisory and research meet the corporate issuer (and IA, where engaged). • Risk if corporate advisory and research discuss valuation issues. • Risk if research participates in pitch meetings. • Risk if corporate advisory commits to (favourable) research if the mandate is secured. • Staff and principal participation in any pre-IPO funding may be a risk area.	**Pre-mandate**	• The corporate issuer (and their IA) and the firm's corporate advisory team may seek a commitment that favourable research coverage be provided, or seek to influence the research valuation. • This may compromise the independence of research, which can result in poorer outcomes for investors and has the potential to mislead the market. • Staff and principal shareholdings may influence the advice provided to the corporate issuer and may influence decisions about pricing of the transaction and research.
• The due diligence process typically includes a briefing of the research analyst. • Risk if JLMs' research analysts are briefed by the corporate issuer together. • Risk where draft research is provided to the corporate issuer for review other than for fact checking.	**Mandate and prospectus preparation**	• If JLM research analysts discuss their approach to valuation during joint briefings this may compromise the independence of research. • If corporate issuers are provided with draft research containing valuation information or recommendations this provides them with an opportunity to seek to influence the research.
• 'Investor education' research is often prepared. • Sales contact potential investors to market the issue. Research analyst involvement in marketing 'investor education'.	**Marketing**	• Research analyst commenting on the corporate issuer beyond the information contained in the prospectus. • Potential conflict in the research analyst promoting a transaction that their firm will receive a financial benefit for completing.
• Bids received and shares allocated. • Risk if the share allocation process includes participation by staff and the firm. • Risk if favourable allocations are made to preferred clients or to executives of companies the firm is seeking to secure future corporate mandates from.	**Allocations and listing**	• Staff and principal bids taking precedence over client bids • Favourable allocations to executives of companies the firm is seeking business from creates the potential for conflicts and a risk that inappropriate inducements are offered.
• Initiation report usually released following a 'blackout' period after the listing (including disclosure of interest). • The firm would usually market the research to investors. • The firm that completed the IPO typically has ongoing contact with the corporate issuer and may have an advisory mandate after the listing.	**Post-listing**	• Staff and principal trading ahead of the research initiation report may create the potential for front running or insider trading. • Inadequate disclosure of interests in research reports. • Staff and principal account trading contrary to published research recommendations. • Risk that MNPI could be passed from the private to the public side of the firm.

Table 6: Placements

Activities (including risk areas)		Potential concerns
• Pitching for a role as lead manager for the transaction. • Research analyst may be wall-crossed to discuss the likely market reaction and effect of the placement. • Potential investors may be wall-crossed to discuss interest in participating in the transaction. • Risk if staff on the public side (e.g. research or sales) discuss capital raisings with corporate issuers to access personal incentive fees. • Risk where staff and principal trading in the corporate issuer occurs ahead of the transaction.	**Pre-mandate**	• Internal pressure for research to provide favourable coverage and for the desk to build market share in the corporate issuer in the lead up to the transaction. • Commercial pressure to secure capital raising fees may result in inappropriate advice being provided to clients or the independence of research being compromised. • Remuneration structures can encourage public-side staff to obtain MNPI from corporate issuers. • Inadequate wall-crossing arrangements, use of restricted lists or monitoring of staff and investors who have been wall-crossed, creates a risk that MNPI may be communicated to the public side or to investors.
• Sales contact potential investors to market the issue. Research analyst involvement in this process.	**Trading halt and marketing**	• Potential conflict in the research analyst promoting a transaction that their firm will receive a financial benefit for completing.
• Bids received and shares allocated. • Risk where allocations are made to staff and principal accounts. • Risk if favourable allocations are made to preferred clients or executives of companies the intermediary is seeking corporate mandates from.	**Allocations and listing**	• Staff and principal orders taking precedence over client orders. • Favourable allocations to executives of companies the firm is seeking business from creates the potential for conflicts, and a risk that inappropriate inducements are offered.
• Updated report may be released commenting on the effect of the placement (including disclosure of interest).	**Placement announced**	• Inadequate disclosure of interests in research reports. • Inappropriate staff and principal trading. • Where a firm acts as an underwriter, any shortfall shares offered to clients should be in accordance with Rule 5.10.5 of the ASIC Market Integrity Rules (ASX) (Chi-X) and (APX).
• Risk where staff and principal trading of shares in the corporate issuer occurs. • Where a firm has an ongoing role with the corporate issuers, appropriate information barriers should be established.	**Placement settled and new shares issued**	• Inadequate disclosure of interests in research reports and when principal trading occurs. • Staff and principal trading contrary to research recommendations may result in poor advice being provided to clients and the potential to mislead the market.

Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s 913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services. Note: This is a definition contained in s 761A of the Corporations Act.
AFS licensee	A person who holds an Australian financial services licence under s 913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
ASIC Market Integrity Rules (APX)	ASIC Market Integrity Rules (APX Market) 2013—rules made by ASIC under s798G of the Corporations Act for trading on SSX
ASIC Market Integrity Rules (ASX)	ASIC Market Integrity Rules (ASX Market) 2010—rules made by ASIC under s798G of the Corporations Act for trading on ASX
ASIC Market Integrity Rules (Chi-X)	ASIC Market Integrity Rules (Chi-X Australia Market) 2011—rules made by ASIC under s798G of the Corporations Act for trading on Chi-X
block trade	An off-market trading mechanism enabling professional market users to arrange and transact orders of significant size
bookbuild	The process where an underwriter attempts to determine the price to offer an IPO based on demand from institutional investors
conflicts of interest	Circumstances where some or all of the interests of clients to whom an AFS licensee (or its representative) provides financial services are inconsistent with, or diverge from, some or all of the interests of the AFS licensee or its representatives. This includes actual, apparent and potential conflicts of interest
corporate advisory activities	Include the provision of capital raising and advisory services to companies and are generally undertaken by investment banking, corporate finance, or equity or debt capital market teams within firms. Corporate advisory assists companies to raise capital (debt and equity) and undertake corporate transactions (such as mergers and acquisitions and takeovers)
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
inside information	Has the meaning given in s1042A of the Corporations Act

Term	Meaning in this document
insider trading	Conduct prohibited under s1043A of the Corporations Act which includes a person who is in possession of inside information (the insider): • acquiring or disposing of securities or procuring another person to do so; and • communicating the inside information to another person if the insider knows, or ought reasonably to know, that the other person would be likely to acquire or dispose of securities or would procure another person to do so
institution	A professional investor (as defined in s9 of the Corporations Act)
investor education	Research prepared by a firm mandated to advise on an IPO and released before the lodging of a prospectus with ASIC
IPO	Initial Public Offering
JLM	Joint lead manager
market participant	A participant within the meaning of s761A of the Corporations Act, in relation to a financial market
MNPI	Material, non-public information
placement	A capital raising by a listed company pursuant to s708 of the Corporations Act
REP 393	An ASIC report (in this example numbered 393)
research report	As defined in RG 79.25–RG 79.26, general advice that is: • in writing; • includes an express or implicit opinion or recommendation about a named or readily identifiable investment product; and • is intended to be, or could reasonably be regarded as being intended to be, broadly distributed (whether directly or indirectly) to clients (whether wholesale or retail) in Australia
research report provider	As defined in RG 79.27, an AFS licensee that provides research reports to other persons (clients). This includes situations where the AFS licensee causes or authorises another person (e.g. an authorised representative of the AFS licensee) to provide research reports to other persons (clients)
RG 79	An ASIC regulatory guide (in this example numbered 79)
SSX (formerly APX)	Sydney Stock Exchange Limited, formerly Asia Pacific Exchange Limited (APX)and Asia Pacific Stock Exchange Limited
s912A	A section of the Corporations Act (in this example numbered 912A) unless otherwise specified
wall-crossed	A person from the public side of an organisation will be 'wall-crossed' if they become aware of MNPI

Related information

Headnotes

advisers, allocations, analyst briefings, conflicts of interest, corporate advisory, information barriers, initial public offerings, inside information, insider trading, investor education, IPOs, joint lead manager, listed entities, market-sensitive information, material information, non-public information, price-sensitive, research analysts, soundings, staff and principal trading, wall-crossing

Regulatory guides

RG 79 *Research report providers: Improving the quality of investment research*

RG 104 *Licensing: Meeting the general obligations*

RG 111 *Content of expert reports*

RG 170 *Prospective financial information*

RG 181 *Licensing: Managing conflicts of interest*

RG 238 *Suspicious activity reporting*

Legislation

ASIC Act, s12DA and 12DB

Corporations Act, s674, 710, 912A, 1041A, 1041H, 1042A, 1043A and 1043B–1043K

Cases

Australian Securities and Investments Commission v Newcrest Mining Limited [2014] FCA 698.

Reports

Report 24 *Research analyst independence*

Report 393 *Handling of confidential information: Briefings and unannounced corporate transactions*

Report 452 *Review of high-frequency trading and dark liquidity*

Consultation papers and reports

CP 46 *Licensing: Managing conflicts of interest*

CP 128 *Handling of material, price-sensitive information*

Other documents

Australian Financial Markets Association, *Handling confidential and price sensitive information and soundings: Best practice guidelines* (PDF 140 KB), 2011

Governance Institute and Australasian Investor Relations Association (AIRA), *Handling confidential, market-sensitive information: Principles of good practice*, 2010

AIRA and Financial Services Institute of Australia (Finsia), *Principles for building better relations between listed entities and analysts*, 2006