



ASIC

Australian Securities & Investments Commission

REPORT 560

Response to submissions on CP 290 Sell-side research

December 2017

About this report

This report highlights the key issues that arose out of the submissions received on [Consultation Paper 290 *Sell-side research*](#) (CP 290) and details our responses to those issues.

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)
- 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.

This report does not contain ASIC policy. Please see [Regulatory Guide 264 Sell-side research](#) (RG 264).

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A Overview/Consultation process

- 1 In [Consultation Paper 290](#) *Sell-side research* (CP 290), we consulted on proposals to provide further guidance on managing conflicts of interest and material, non-public information (MNPI) involving sell-side research.
- 2 Our consultation followed the release in August 2016 of [Report 486](#) *Sell-side research and corporate advisory: Confidential information and conflicts* (REP 486). REP 486 set out key observations from our review of how MNPI and conflicts of interest are handled in the context of sell-side research and corporate advisory activities.
- 3 Our review showed that AFS licensees involved in providing research would benefit from detailed guidance on managing MNPI and conflicts of interest.
- 4 Our proposed guidance supplemented [Regulatory Guide 79](#) *Research report providers: Improving the quality of investment research* (RG 79), and set out our expectations of how licensees should handle MNPI and manage conflicts of interest in the provision of sell-side research.
- 5 This report highlights the key issues that arose out of the submissions received on CP 290 and our responses to those issues.
- 6 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 290. We have limited this report to the key issues.
- 7 We received 22 confidential and 7 non-confidential responses to CP 290. We are grateful to respondents for taking the time to send us their comments.
- 8 For a list of the non-confidential respondents to CP 290, see the appendix. Copies of these submissions are currently on the ASIC website under [CP 290](#).

Responses to consultation

- 9 The main issues raised by respondents related to our proposed guidance on:
 - (a) research analysts and information management (referred to in CP 290 as 'Research analysts and MNPI');
 - (b) managing research conflicts during the capital raising process – pre-mandate;
 - (c) the role of research in the post-mandate stage and in the production of the investor education report (IER); and
 - (d) the structure and funding of research.

B Research analysts and information management

Key points

This section outlines the feedback received on our proposed guidance on how inside information can be identified and managed in the context of sell-side research.

Specifically, the feedback relates to:

- our proposed definition of sell-side research;
- material, non-public information (now referred to as 'inside information');
- research analyst declarations; and
- requests for research analyst models.

Definition of sell-side research

- 10 We proposed a definition of sell-side research that provides further detail on the definition of research reports contained in RG 79. We sought to clarify that the definition of sell-side research includes desk notes, emails and flash notes (other than those that are merely a restatement, summary or extract of other research that has already been distributed), provided it is clear that:
- (a) the advice is a restatement, summary or extract of other research; and
 - (b) readers are directed to who prepared the original research and, if available, how readers may obtain it.
- 11 We amended the definition of sell-side research to ensure that the regulatory requirements for sell-side research would apply to desk notes, emails and flash notes that have the attributes of research.
- 12 We also proposed to include research principally focused on general economic or business issues, but which is intended, or could reasonably be intended, to influence an investor on particular financial products or particular classes of financial products in the definition of sell-side research.

Stakeholder feedback

- 13 We received a number of submissions suggesting that our proposed definition of sell-side research was too broad and would place a significant compliance burden on licensees to review the likely increase in material that would meet the amended definition of 'sell-side research'.

- 14 Respondents also noted that extending the definition of sell-side research to research covering ‘business issues’ was broad and may inadvertently capture general market commentary, despite it having limited ability to influence investor decisions on particular financial products or classes of products.

ASIC’s response

To address this feedback, we have amended the definition of sell-side research to clarify that it is limited to desk notes, emails or flash notes that:

- contain a price target or valuation about named or readily identifiable financial products or classes of financial products; and
- are not commentary which references the most recent research that has been broadly distributed by the licensee or another person in relation to the financial product(s) referred to in the desk note, email or flash note.

These amendments provide sufficient scope for licensees to produce desk notes, emails and flash notes to assist with the timely communication of information and opinions about financial products.

Where, however, these communications contain price targets or valuations for financial products for which no current research has been broadly distributed, then we consider these communications should be characterised as sell-side research.

We have also amended the definition of sell-side research to include economic or fixed income research which includes an express or implicit opinion or recommendation about named or readily identifiable financial products or classes of financial products.

Application to fixed income research

- 15 RG 79 applies to fixed income research. We sought feedback on whether our guidance should extend to sell-side research on fixed income products (bonds and hybrids) and, if so, what adjustments should be made in its application to this type of research.

Stakeholder feedback

- 16 Feedback was mixed on whether our sell-side guidance should apply to fixed income research. Responses though emphasised that the fixed income market is much less sensitive to analyst opinion than it is for the equity market. The point was made that bond prices tend to be driven much more by credit ratings than by research reports.

ASIC's response

Our sell-side guidance applies to fixed income research. The guidance acknowledges, however, that licensees need to consider the dynamics of the market in which financial products trade when assessing the materiality of the information. We give the example of information on a company that may materially affect the price of shares it has issued but not the price of its bonds.

We also state that permanent information barriers may not be warranted for fixed income research but that licensees should consider implementing barriers on a case-by-case basis for fixed income research that may materially affect the prices of bonds or other financial products.

Material, non-public information

- 17 In CP 290, we proposed to use the term ‘material, non-public information’ (MNPI) when referring to inside information as it is more descriptive of the type of information that licensees need to handle carefully in order to avoid breaching s1042A of the *Corporations Act 2001* (Corporations Act).
- 18 Consistent with s1042A of the Corporations Act, MNPI was defined as information that:
- (a) is not generally available; and
 - (b) if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of particular financial products.

Stakeholder feedback

- 19 The feedback highlighted some difficulties with the use of the term ‘material, non-public information’ (or ‘MNPI’) rather than the term ‘inside information’. Respondents expressed the view that ASIC should use terminology consistent with the Corporations Act.

ASIC's response

We agree with the submissions and will now use the term ‘inside information’ rather than the term ‘material, non-public information’ (or ‘MNPI’) in our guidance.

Research analyst declarations

- 20 We proposed that sell-side research should include a declaration from the research analyst:
- (a) as to whether they have been in contact with the company, the subject of the research, in the month before the research's publication;
 - (b) that they are not in receipt of MNPI and the research does not contain MNPI; and
 - (c) that no attempt has been made by any other part of the licensee to influence valuation information.

Stakeholder feedback

- 21 We received a range of responses to this proposal. Feedback received largely disagreed with our proposal requiring research reports to include a *public* declaration by the research analyst declaring that the research report 'does not contain inside information'.
- 22 Respondents noted that should the research report inadvertently contain inside information it may expose a research analyst to personal liability. Furthermore, contact with the company that is the subject of the research is part of a research analyst's role and such a declaration was unlikely to provide any additional insight to investors.

ASIC's response

We have addressed this feedback by amending our guidance.

Before the publication of research, the research analyst(s) who prepared the report should provide an internal declaration to the licensee's compliance or another control function that:

- to the best of the research analyst's knowledge, they are not in receipt of inside information and the research does not contain inside information; and
- no attempt has been made by any other part of the licensee to influence the research.

Our revised guidance does not recommend that the research analyst needs to confirm any contact with the subject company in the month before the publication of the research. We acknowledge that such interaction is part of a research analyst's role.

Requests for research analyst models

- 23 In CP 290 we proposed that internal and external requests for a research analyst's models should be managed by compliance or another control function, without the research analyst being made aware that a request had been made or who made the request.

Stakeholder feedback

- 24 We received submissions which largely disagreed with our proposal that all requests for a research analyst's models should be managed by compliance or another control function. Respondents argued that this was overly prescriptive and would add significantly to a licensee's compliance burden. Respondents suggested that external requests from investors should not be subject to a compliance handling requirement as this type of request presents a lower risk that a research analyst may be tipped off about a potential corporate transaction.

ASIC's response

We have amended the guidance so that only internal requests for research analyst models should be managed by compliance or another control function.

Research analyst interactions

Stakeholder feedback

- 25 We received feedback that our proposed guidance may inadvertently restrict research analyst interactions with listed companies where the licensee's corporate advisory team was pitching for or engaged to undertake a capital raising transaction of which the research analyst was unaware. Respondents noted that if our proposals were adopted, even where the research analyst had no knowledge of a particular transaction and had not been informed of a potential capital raising, the research analyst would not be permitted to conduct ordinary course conversations with the issuing company.

ASIC's response

We agree with the feedback received. We have amended our guidance to clarify that the research analyst may interact with listed companies where the research analyst is unaware of a potential capital raising transaction.

We have further clarified in our guidance that normal course research coverage, together with normal course interactions with the issuing company, may take place until such time as the research analyst becomes aware of, or is wall crossed (if at all) in relation to, the particular capital raising transaction.

C Managing research conflicts during the capital raising process (pre-solicitation and pitching)

Key points

This section outlines the feedback received on our proposed guidance on the controls licensees should have in place for each stage of the capital raising process.

Specifically, the feedback relates to:

- the capital raising process;
- the pre-solicitation and vetting stages;
- the pitching stage; and
- research analyst input into underwriting decisions.

Capital raising stages

- 26 In CP 290 we outlined four stages in capital raising transactions (pre-solicitation, transaction vetting, transaction pitching and the post-mandate stage) and proposed various controls for each stage to protect the objectivity and independence of research analysts.

Stakeholder feedback

- 27 We received a significant number of submissions explaining that transaction phases are not always linear or chronological—some phases overlap. Many respondents suggested that fewer, clearly defined phases should be adopted (e.g. pre-pitch, pitch and post-appointment) or licensees should explicitly be permitted to take a commercial view about which phase (or phases) they were currently operating under.
- 28 Respondents submitted that transaction vetting decisions are taken at different stages by many licensees and are an important internal check in the process of evaluating whether a licensee should participate in a particular transaction. Rather than operating as a separate stage in the capital raising process, it was noted that vetting is a function that the licensee undertakes.

ASIC's response

We have addressed these submissions by removing transaction vetting as a stage and incorporating it into a revised pre-solicitation phase. This will allow for greater interaction between a licensee's research and corporate advisory teams before a

decision is made to pitch for a transaction, including discussion of valuation information.

Our guidance now outlines three stages in capital raising transactions:

- *pre-solicitation* – when a licensee becomes aware of, or approaches a company in relation to, a potential capital raising transaction;
- *transaction pitching* – a licensee preparing and submitting a proposal to seek a capital raising mandate; and
- *post-appointment* – due diligence and preparing selling documentation in relation to a capital raising transaction. For IPOs this includes preparing and distributing an IER.

Pre-solicitation and vetting stages

- 29 In CP 290 we defined the pre-solicitation stage as interactions that occur before a licensee becomes aware of a potential transaction. This stage was followed by a vetting stage, where a licensee undertakes internal assessments about whether to pitch on a transaction.
- 30 We proposed a range of controls during the pre-solicitation stage, including no discussion of company valuation information by research analysts in three-way meetings with corporate advisory and a company. We also proposed that during the vetting stage research analysts and corporate advisory could not discuss valuation information and that research analysts should not interact with the issuing company during this stage.

Stakeholder feedback

- 31 We received feedback that transaction vetting is an important function in the process of evaluating whether a licensee should seek a mandate for a particular transaction.
- 32 Respondents noted that the consideration of valuation and the appropriate valuation methodology is important in assessing transaction risk for a licensee. It was also submitted that prohibiting discussion of valuation information between corporate advisory and research analysts with expertise in the relevant sector would be detrimental to the capital raising process.

ASIC's response

The pre-solicitation stage has been modified to cover the period from when a licensee becomes aware of, or approaches a company in relation to, a potential capital raising transaction, and incorporates transaction vetting.

Analysts may participate in internal deliberations on whether to seek a transaction mandate. For listed companies, research analysts and corporate advisory can discuss a potential capital raising transaction or valuation information, provided the research analyst has been wall-crossed.

Research analysts can interact with corporate issuers in the period before the licensee decides to pitch for a transaction or seven days before the pitch presentation, whichever is earlier. The issuing company or its advisers should not ask research analysts questions about valuation information in these interactions.

Pitching stage

- 33 We proposed a range of controls to minimise the risk of a research analyst being pressured about their assessment of a company, which could affect the subsequent objectivity and independence of the resulting research and the research analyst's view of valuation information in relation to the company.
- 34 The guidance outlined how licensees should manage their research analysts' interactions with corporate advisory and the issuing company during the pitching stage.

Stakeholder feedback

- 35 We received feedback that outlined the importance of research analyst involvement during pitching to allow for the ongoing, appropriate conduct of the transaction vetting.
- 36 Feedback also outlined the additional costs of proposed compliance chaperoning of research analyst interactions with the issuing company during the pitching stage.

ASIC's response

We have removed the guideline for compliance chaperoning of a research analyst and the issuing company during pitching as these interactions should no longer occur.

Our guidance that research analysts should not interact with the issuing company during pitching remains.

Research analyst input in underwriting decisions

- 37 Our draft guidance did not allow for research analysts to participate in the underwriting decisions of the licensee in the period before an IER is widely distributed. We were concerned that if the research analyst participated in due diligence before an IER was widely distributed then there was a risk that the research analyst would provide advance notice of the valuation information in the IER.

Stakeholder feedback

- 38 We received feedback about the importance of research analyst input during a licensee's underwriting deliberations, with respondents noting their role as sector specialists who can also help with insight on likely investor demand. Feedback was that our proposal had the potential to compromise licensees' ability to properly assess transaction risk and thereby negatively affect the capital creation process.

ASIC's response

Our guidance allows a research analyst to participate in the final underwriting decision of the licensee, subject to it being limited to the period shortly before the underwriting decision is made.

Research analyst input should be limited to underwriting risk, and should not be used as a mechanism to disclose the contents of the IER.

D Investor education reports

Key points

This section outlines the feedback received on our proposed guidance on the controls licensees should have in place for IERs.

Specifically, the feedback relates to:

- the value of an IER in the capital raising process;
- valuation information in the IER; and
- replacement of an IER.

The value of an IER

- 39 We sought general feedback on whether the conflicts in preparing and distributing research in support of an IPO are so great they can only be managed through avoidance. In particular, we queried whether an IER should be prepared or, if it is, whether it should contain valuation information.

Stakeholder feedback

- 40 We received feedback that, in the context of Australian capital market transactions, an IER plays a significant role in the capital creation process. Respondents noted that an IER helps with the price discovery process by providing a mechanism for potential investors to express their views of the issuing company's business and its likely valuation.

ASIC's response

We acknowledge the role an IER plays in the IPO process, and consider that the inherent conflicts in IERs should be capable of being managed through conformance with our regulatory guidance.

We will continue to monitor IERs and will revisit the issue if we find that poor management of conflicts compromises their integrity.

Valuation information in IERs

- 41 We sought feedback as to whether excluding valuation information from IERs would help licensees manage conflicts of interest.

Stakeholder feedback

- 42 We received extensive feedback with a wide range of opinions about whether valuation information should be included in an IER. Some respondents submitted that conflicts inherent in IERs could be reduced by removing the overall price target or valuation range from IERs, meaning that a number of the controls in our proposed guidance could be removed. However, proponents of this position thought that other valuation information (such as suggested comparable listed companies, appropriate valuation metric multiples and a discounted cash flow analysis) should remain in IERs.
- 43 Other respondents noted that investors derive benefit from the inclusion of valuation information in IERs and that any conflicts are and can continue to be managed by licensees. Other feedback was that investor clients understand the inherent conflicts in connected IER research and take this into account when assessing the value and reliability of an IER.

ASIC's response

Our revised guidance does not recommend that valuation information be removed from IERs for the following reasons:

- valuation information can assist in the price discovery process;
- removing the overall price target or valuation range would still provide a significant amount of valuation information and investors would still be able to calculate an analyst's views on the overall price or valuation range; and
- we have recommended a range of controls on the interactions between research analysts and corporate advisory and issuing companies to minimise the risk that undue pressure or influence may be applied to research analysts.

We will continue to monitor the issue of valuation information in IERs, and will consider further guidance if necessary.

Replacement of an IER

- 44 We proposed that an IER should not be amended, updated, reissued or replaced following distribution as there is a risk that corporate advisory colleagues or an issuing company may place pressure on an analyst if they are disappointed in that analyst's IER. We also sought feedback on the

proposal that if new information comes to light following the release of an IER (but before the transaction is complete) which renders material statements or information in the IER false, misleading or deceptive, the IER should simply be withdrawn.

Stakeholder feedback

- 45 Feedback from industry opposed our proposal that an IER should not be updated or reissued following its distribution to potential investors, even if new information comes to hand which renders the IER misleading or deceptive. This was particularly the case given that the draft guidance did not allow for a licensee's corporate advisory team to review the IER before its distribution to investors.
- 46 Many licensees also wanted corporate advisory to be able to review the draft IER before it was widely distributed. It was submitted that corporate advisory have detailed knowledge of the issuing company and could identify any errors or omission in the IER.
- 47 Respondents also noted that the market may assume that the IER has been withdrawn because new information has been identified that is fundamentally detrimental to the issuing company. This may adversely affect the capital raising transaction.

ASIC's response

We have revised our guidance to provide that an IER can be amended if errors are identified or new information comes to light after the release of the IER which renders statements or information in the IER materially false, misleading or deceptive.

Any changes in the IER must be clearly identified in the replacement IER, including the reason for the change.

Our guidance continues to state that a licensee's corporate advisory team or the issuing company's non-legal advisers should not review draft IERs. We are concerned that allowing corporate advisory to review draft IERs creates a high risk that undue influence may be applied to a research analyst to have a valuation that is favourable to the issuing company.

A licensee's compliance or legal advisers can review a draft copy of the IER, as can the issuing company and its legal advisers, provided valuation information is redacted.

E Structure and funding of research

Key points

This section outlines the feedback on our proposed guidance on the controls licensees should have in place to ensure that the structure of business models and the funding of research teams do not compromise research independence.

Specifically, the feedback relates to:

- decision-making on research coverage; and
- the structure of research.

Decision-making on coverage

- 48 We proposed guidance to clarify the types of controls licensees should implement to manage conflicts of interest when making decisions to provide research coverage.
- 49 In particular, we proposed that a licensee should publish on its website:
- (a) how it selects a company for research coverage; and
 - (b) the decision and rationale by the licensee to initiate or terminate coverage of a company.

Stakeholder feedback

- 50 Feedback from industry overwhelmingly opposed our proposal for licensees to publish on their website the criteria for selecting a company for research coverage. Respondents noted that such information was proprietary, and suggested that a summary of policies could instead be provided.

ASIC's response

We have addressed this feedback by amending our guidance.

Our revised guidance indicates that licensees should make it clear to users (and prospective users) how a research report provider makes coverage decisions, including the criteria they apply and any important limitations.

Disclosure of interests in research

- 51 Our proposed guidance specified our expectations that disclosure of interests in research should include the number of shares and options (including the average acquisition price for shares and the average exercise price for options) held by:
- (a) the research analyst who prepared the research; and
 - (b) the five largest share and options holders at the licensee.

Stakeholder feedback

- 52 Industry strongly opposed our proposals for research disclosures to include the number of shares and options held by the research analyst who prepared the report and the five largest shareholders at the licensee.
- 53 Respondents noted that our proposal exceeded the requirements in other jurisdictions, and may require disclosure of interests that present no actual, apparent or perceived conflict of interest. Feedback was that common practice is for the research analyst who prepared the report to disclose whether they hold any securities in the entity mentioned in the report. Others noted that their research analysts were not permitted to hold positions in listed companies they researched. A repeated theme in the feedback was the burden of the proposed disclosure which would require increased compliance resourcing and IT development costs.

ASIC's response

Our revised guidance states that the disclosure of interests in research should include prominent, specific and meaningful information about a licensee's (and its associates') conflicts.

Our guidance will contain examples of the type of disclosure that we expect, which may include disclosure of the number of shares and options held by the licensee and its staff.

Appendix: List of non-confidential respondents

- Association of Securities and Derivatives Advisers of Australia Ltd (ASDAA)
 - Australian Financial Markets Association (AFMA)
 - Euroz Securities Limited
 - Financial Planning Association of Australia
 - Law Council of Australia
 - Stockbrokers and Financial Advisers Association Limited (SAFAA)
 - Zenith Investment Partners
-