Attachment to CS 59: Draft regulatory guide

REGULATORY GUIDE 264

Sell-side research

Issue date

About this guide

This guide is for AFS licensees who are involved in providing research.

It provides principles-based guidance on managing inside information; and conflicts of interest when providing sell-side research.

It supplements our guidance in Regulatory Guide 79 *Research report providers: Improving the quality of investment research* (RG 79).

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.

Document history

This draft guide was issued in Issue date and is based on legislation and regulations as at the date of issue.

Previous versions:

- Superseded Regulatory Guide 264, issued December 2017

Disclaimer

This guide 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 guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Sell-side research

Key points

As an Australian financial services (AFS) licensee who provides sell-side research, you must have arrangements in place to manage inside information and conflicts of interest: see RG 264.1–RG 264.6.

This guide sets out:

- what qualifies as sell-side research (see RG 264.7–RG 264.9); and
- principles-based guidance on how to comply with your legal and regulatory obligations when providing sell-side research (see Table 1).

Your obligations for managing inside information and conflicts of interests

Management of inside information

RG 264.1 Research analysts obtain information from and about companies that may include inside information. For example, information about a capital raising transaction, or a company's operations or financial performance that is not generally available.

RG 264.2 Poor practices in the handling and assessing of inside information may lead to contraventions of the insider trading prohibition in the *Corporations Act 2001* (Corporations Act) and damage market integrity.

Management of conflicts of interest

RG 264.3 Your business model, structure and incentives can create potential conflicts of interest between you and your investing and corporate advisory clients. For example, your corporate advisory team may have an incentive to ensure your research analysts produce favourable research to help the corporate advisory team be appointed to manage a capital raising transaction (also known as a 'mandate'). This may result in pressure being applied to research analysts that compromises the integrity of research.

RG 264.4 Investors rely on the research you provide. It must be accurate and unbiased to ensure investor protection and support market integrity.

RG 264.5 Managing conflicts of interest is also part of your AFS licensing obligations: see s912A(1)(aa) of the Corporations Act. For guidance on how to manage conflicts of interest generally, see Regulatory Guide 181 *AFS licensing: Managing conflicts of interest* (RG 181).

Research analyst interactions during capital raising transactions

RG 264.6 You may seek research analysts' specialist input on aspects of capital raising transactions, such as deal selection, material due diligence issues and input into underwriting decisions. Where research analysts interact with corporate advisory teams or issuers, this creates an increased risk of conflicts of interest. You need strong controls to manage these potential conflicts, and avoid them where possible.

Sell-side research helps your clients make investment decisions about financial products

RG 264.7 In this guide, 'sell-side research' is general financial advice you prepare and distribute to your clients (or potential clients) to help them make investment decisions about financial products. This advice includes an express or implicit opinion or recommendation about named or readily identifiable financial products, or classes of financial products. Generally, you will provide this advice in writing, audio, video or another electronic format.

RG 264.8 Sell-side research includes:

(a) research you prepare about a capital raising transaction (usually an initial public offering (IPO)) that you release before an issuing company's securities are listed;

(b) research you prepare about a listed company undertaking a recent transaction (e.g. an IPO or placement). You may or may not have been involved in the transaction;

(c) periodic research (typically following an event, such as a release of results, an acquisition or divestment or a material change to the company or its business);

(d) desk notes, emails and flash notes that:

  (i) contain a price target or valuation about named or readily identifiable financial products or classes of financial products; and

  (ii) exclude commentary referencing the most recent research you (or another person), have broadly distributed relating to the financial product(s) referred to in the desk note, email or flash note.

(e) economic or fixed income research that includes an express or implicit opinion or recommendation about named or readily identifiable financial products or classes of financial products.

RG 264.9 Sell-side research does *not* include any of the following:

(a) personal advice;

(b) general advice that is provided only to an individual or small number of related clients (e.g. a family);

(c) general advice that is provided only to related bodies corporate of the licensee;

(d) a restatement of a listed company announcement; and

(e) advice that is merely a restatement, summary or extract of another research report that has already been distributed (whether by the licensee or another person), provided it is clear that:

  (i) the advice is a restatement, summary or extract of another report; and

  (ii) readers are directed to who prepared the original research and, if available, how readers may obtain it.

Principles for AFS licensees preparing sell-side research

Table 1: Principles and considerations to help you comply with your legal and regulatory obligations when providing research

Principle	Why it matters	Considerations for AFS licensees
1. Inside information You should have policies and procedures to identify and manage inside information obtained by research analysts.	Poor handling of inside information: • increases the risk that you will contravene insider trading laws; and • undermines market integrity.	You should consider implementing the following arrangements to manage inside information: • Policies and procedures that define inside information, explain how to identify it, describe what staff are to do if they receive it (e.g. when a research analyst is 'wall-crossed'), and set out escalation paths supported by regular training. Note: A person who is 'wall-crossed' is someone from the public side of an organisation who becomes aware of inside information. • A requirement that research analysts provide a declaration to the licensee's compliance or another control function before publishing research, confirming that they are not in receipt of inside information and that no other parts of your business or the issuing company have made any attempt to influence the research. • An appropriate review process for initiation of research, changes to recommendations and material changes to price targets in research. • A process to deal with requests for research analyst models—managed by your compliance team—to ensure the models are consistent with published research and to mitigate the risk that a model may communicate inside information.

Principle	Why it matters	Considerations for AFS licensees
2. Conflicts of interest You need strong and effective controls to identify and manage potential conflicts of interest and avoid them where possible.	Conflicts, whether actual, apparent or potential, can reduce the quality, integrity and reliability of research.	You should consider implementing the following arrangements to manage conflicts of interest: • Controls around the limited situations where research analysts may be involved in aspects of a capital raising transaction (e.g. deal selection, material due diligence issues and underwriting decisions) where there are increased risks of the research analyst being influenced. • A policy that research analysts will not be involved in pitching for capital raising transactions, unless they have been wall-crossed. Once wall-crossed, the research analyst cannot produce research in relation to the issuing company or the transaction until the transaction has been completed. • A policy that your corporate advisory team will not: – represent to issuers that research analysts endorse valuation outputs or will provide favourable research; – commit to providing research when seeking to be appointed to a capital raising transaction; and – place pressure on research analysts or influence their research (including investor education reports). You may consider requiring the head of corporate advisory to provide an annual declaration to compliance that they, or members of the corporate advisory team (after making reasonable enquiries), have not sought to influence the research team. • Effective controls to manage the risk of fee structures that can create or exacerbate conflicts of interest (e.g. discretionary fees). • Disclosure of interests in research that are prominent, specific, meaningful and clearly describe your (and your associates') conflicts.

Principle	Why it matters	Considerations for AFS licensees
3. Investor education reports (IERs) IERs should be unbiased, reflect the professional judgement and expertise of the research analyst, and not undermine the prospectus as the primary disclosure document. Note: IERs are prepared by an AFS licensee appointed to advise on a capital raising transaction and are typically released before the issuer lodges its prospectus with ASIC.	Biased or inaccurate IERs can undermine the primacy of the prospectus and mislead investors during capital raisings.	You should consider implementing the following arrangements for IERs: • A policy that research analysts may only attend briefings with the issuing company if your business has been appointed to the relevant transaction. Views on valuation should not be discussed in these briefings. • Controls and mechanisms to ensure that IERs are unbiased and reflect the independent view and expertise of the research analyst, and be based on information that is, or is expected to be, disclosed in the prospectus. • A policy that research analysts and your corporate advisory team will not communicate from the time the corporate advisory team is appointed to the transaction until the IER has been widely released—except in limited circumstances. These include material due diligence issues and underwriting decisions. You should have arrangements in place to mitigate the risk of the research analyst being influenced and if the research analyst obtains inside information, they should be wall-crossed. • A policy that you will only release the IER after your corporate advisory team has been appointed to the relevant transaction. • A policy that any valuation information in the IER will be: – expressed as an enterprise value or total value for the issuing company; and – based on the financial information in the prospectus. • Procedures to ensure drafts of IERs, including research analyst models and working files, are not shared outside research until the IER has been widely released. • Fact checking of draft IERs can be undertaken by: – compliance or another control function and/or legal advisers; and – the issuer and its legal advisers, provided all valuation information has been redacted and they do not share the draft IER or opinions to any other party. The feedback process should be managed by the compliance team with feedback limited to factual or legal observations only. • To maintain the primacy of the prospectus, procedures that ensure there are no material time gaps between the release of IER and the draft (or pathfinder) prospectus.

Principle	Why it matters	Considerations for AFS licensees
4. Monitoring and oversight You should have robust compliance and supervisory arrangements to assess the effectiveness of your controls.	Ineffective monitoring, oversight and control frameworks increase the risk of misconduct and breaches of financial services law.	You should consider implementing the following arrangements to monitor and oversee the effectiveness of your controls: • Testing for compliance with your policies and procedures for: – handling inside information; – managing of conflicts of interest; – wall-crossing procedures; – communications, including research analyst interactions with the corporate advisory team and issuers; and – research and capital raising transactions. • Ongoing monitoring and/or periodic reviews, as appropriate. • Your staff complete regular training on their regulatory obligations. Your controls should not rely only on staff integrity. They should involve active review and oversight, and include appropriate record keeping.
5. The structure and funding of research You should ensure that the structure and funding of your research teams do not affect the independence of their research.	If research teams are not structurally and financially independent, commercial pressures may influence their research. This will damage investor confidence and participation.	You should consider implementing the following arrangements for the structure and funding of your research: • Research analysts are segregated (physically and technologically) from the corporate advisory and sales teams, and should not be supervised by those functions. • Procedures to ensure unpublished research or changes to recommendations (including IERs) are restricted to the research team until the research is widely distributed except for fact checking of IERs in the limited circumstances set out in Item 3 above. • Only the research team can decide the companies they monitor and publish research about. Their decisions should not be influenced by other parts of your business. • Senior management determines research budgets, with no input from the corporate advisory team. • The corporate advisory team does not provide input into research analyst performance or remuneration. • Research analyst compensation is not tied to corporate advisory revenues.

Note: See page 10 for a summary of the guidance.

KEY PRINCIPLES FOR AFS LICENSEES PROVIDING SELL-SIDE RESEARCH

WHAT IS SELL-SIDE RESEARCH?

Sell-side research is **general financial advice** prepared and distributed by a **licensee to its clients** to help them make **investment decisions** about financial products.

OVERVIEW

This guide is for AFS licensees who provide sell-side research. It supplements RG 79.

The guide focuses on managing inside information and conflicts of interest when providing sell-side research.

Poor handling of inside information can increase the risk of insider trading and undermine market integrity.

Conflicts of interest need to be managed appropriately because they can compromise research integrity and reduce investor confidence.

1 Inside information

Maintain policies and procedures for identifying, and handling inside information.

Require pre-publication declaration from research analysts confirming no inside information used nor attempts to influence research.

Review controls for initiation and material amendments to research.

2 Conflicts of interest

Limit research analyst role in captial raisings including wall-crossing if involved in pitches.

Prevent corporate advisory influence over research in pitches or mandates.

Manage conflicted fee structures.

Research disclosures should be prominent, specific and meaningful.

3 Investor education reports (IERs)

Research analysts can attend issuer briefings post appointment but cannot discuss valuation.

IERs should be unbiased and consistent with prospectus information.

Restrict research and corporate advisory communciations post appointment until IER is released except in limited situations.

Limit timing gaps between release of IER and pathfinder prospectus.

Controls and limitations on fact checking and sharing draft IER.

4 Monitoring and oversight

Effective compliance and supervision arrangements in place.

Implement ongoing monitoring, periodic reviews and targeted testing.

Provide regular staff training and maintain adequate record-keeping.

5 Structure and funding of research

Segregate research team from corporate advisory and sales teams.

Restrict non-research staff access to unpublished research (including IERs).

Ensure independence of research, coverage decisions, budgets and remuneration.