CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

19 February 2010

Kate O'Rourke
Senior Manager
Corporations
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2001

By email: kate.o'rourke@asic.gov.au

Dear Ms O'Rourke

Handling confidential information

Chartered Secretaries Australia (CSA) is the independent leader in governance, risk and compliance. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency. Members of CSA deal on a day-to-day basis with the Australian Securities and Investments Commission (ASIC) and have a thorough working knowledge of the operations of the financial markets, the needs of investors and the Corporations Act.

General comments

CSA strongly supports the proper handling of confidential information and welcomes guidance from ASIC on ways to achieve this. Reducing the risk of leaks or insider trading promotes and preserves market integrity. Indeed, CSA notes that many companies, particularly larger companies, already have in place systems and processes to ensure the proper handling of confidential information that largely align with the systems and processes recommended by ASIC.

CSA welcomes the guidance proposed by ASIC in *Consultation paper 128: Handling confidential information* (the consultation paper), and notes that many aspects canvassed in the paper reflect the practice already in place in a great many companies. Our comments on the following pages are offered within the context of seeking a framework that balances the needs of an informed market and confidence in market integrity with the need to ensure that any guidance relating to the handling of confidential information does not impose excessive cost or burdensome administration on companies of all sizes.

Large companies are likely to have the resources to dedicate to the practices proposed by ASIC. However, given that the majority of the companies listed on the Australian Securities Exchange (ASX) are small-to-medium sized entities, CSA is of the view that any guidance needs to ensure that it is also appropriate and effective for smaller companies with more limited resources.

Appropriate processes for handling confidential information need to be tailored to various factors, such as the size of the company, the size of the transaction and the commercial imperatives and timing of a transaction.

CSA notes that the ASIC consultation paper states that:

> In proposing best practice guidelines for the handling of confidential information we recognise that individual companies and advisory firms in receipt of confidential information need to consider their own needs and circumstances when implementing these policies and procedures.

However, CSA also notes that the proposed guidance will be issued under the title of a Regulatory Guide, which ASIC itself defines as 'explaining how ASIC interprets the law'. CSA has concerns that, under this banner, the best practice guidelines have the potential to be interpreted as the sole approach to the handling of confidential information, regardless of the size of the company, the size of the transaction or the commercial imperatives of a particular transaction. For example, it is unclear if the best practice guidelines would have evidentiary value in the case of any litigation. ASIC does not clarify if the purpose of the guidelines is to determine whether or not it would bring an action against a party.

CSA understands that one valuable effect of the guidelines is to focus the attention of all parties on a culture of compliance and supports this outcome, but believes that the Regulatory Guide needs to acknowledge more clearly that the guidelines are intended to inform practice and are not set in stone as the only possible approach to the handling of confidential information.

For example, a very large capital raising may take place over two or three days, from conception to finalisation. Conversley, an idea for a transaction may be discussed internally within a company over many months or years before transitioning into a formal transaction. It can be difficult to pinpoint the exact moment when such a transition occurs and when transaction-specific information handling processes should be put in place. Moreover, while large companies may undertake very large transactions, they may also undertake small transactions, which will have little or no impact on the company's share price and therefore may not require the same processes for handling information as large transactions.

The guidelines also appear to assume that a company will usually have an existing relationship in place with external advisers or service providers prior to any transaction taking place. CSA members note that this may not be the case, with corporate transactions frequently taking place very rapidly based on proposals received from external advisers with no existing relationship with the company. For example, an investment bank may approach a company in relation to a capital raising based on market soundings it has conducted of which the company has no prior knowledge.

Finally, CSA agrees with ASIC that it is the responsibility of all parties to ensure their own systems and procedures are sufficiently robust and effective to minimise the risk of leaks to the maximum extent possible, but notes that our comments on the following pages stem from the perspective of the company and its board members and employees. CSA members cannot speak on behalf of advisers and service providers, but note that their cooperation is essential if sound practice is to be implemented.

B: Best practice guidelines

CSA strongly supports the use of best practice guidelines as the appropriate mechanism to promote market integrity and reduce the risks of leaks and insider trading, rather than the introduction of further regulatory measures or law reform. CSA notes again the need for the best practice guidelines to explicitly acknowledge the need for a subtlety of approach and a tailoring of the recommended policies and procedures to the size of the company, the size of the transaction and the commercial timeframes of particular transactions.

C: Internal corporate policies and procedures

C1: Insider lists for sensitive matters

CSA supports companies maintaining a comprehensive register of all people who are insiders on sensitive transactions.

CSA notes that the aim is to compile as complete a register as possible, including people, such as secretarial support staff, who can sometimes be overlooked when compiling a register, even though they may also have access to the sensitive information. Capturing all such people can prove slightly problematic, particularly if a transaction is proceeding very rapidly, as, for example, sensitive information may be extended to a number of support staff to expedite the preparation of materials, and it is feasible that the register may not include the names of one or two people. CSA also notes that a company may have a number of different registers in place relating to different transactions that are proceeding simultaneously.

Therefore, **CSA strongly recommends** that the inadvertent absence of a person with access to sensitive information should not be taken as demonstrating a culture of non-compliance**. CSA recommends** that the visible efforts to maintain control of a register showing the names of all people with access to sensitive information should be used by ASIC to determine that a culture of compliance exists.

Also, it is important that an 'insider list' not be used as a reason for failing to provide access to information to those who require it in order to ensure good governance and oversight in a company. CSA submits that the guidelines should make clear that the board of directors and internal and external auditors should always be entitled to access information concerning a transaction which is necessary to discharge their duties. The names of directors and auditors who do access such information should of course be added to the appropriate register.

CSA strongly agrees that the company is the most appropriate party to hold the responsibility for maintaining a register of all insiders on sensitive transactions, subject to the company being able to require third parties, for example, an investment bank, to supply the names of all staff who have access to the sensitive information. That is, the advisers and service providers must maintain the same level of diligence as the company in order for the company to satisfactorily maintain a register of all people who are insiders on sensitive information to reduce the risk of leaks or inappropriate distribution of the information.

CSA points to the practical difficulties of keeping track of sensitive information, particularly when it is distributed by email**. CSA recommends** that companies have proper mechanisms in place to track email and password-protected documents in email, as well as access granted to printed documents. Such a mechanism could be a document management system, although that should not be prescribed. CSA notes that these email tracking processes are similar to those that many companies have in place to manage documents which might be required in connection with litigation.

C2: Classification of documents

CSA is of the view that, while it might be theoretically attractive to assign classifications to documents according to the level of protection each document requires, it is difficult to apply such a classification system in practice. When multiple classifications exist, it can become very difficult for people to decide easily into which classification a document belongs. There will always be some documents that are highly sensitive and therefore easily classified as requiring protection. However, other documents will not be so readily identified as sensitive. Timing can also change the classification of a document, rendering it either sensitive or non-sensitive.

CSA is concerned that one possible outcome of requiring a classification system as proposed, which would be to the detriment of the proper handling of confidential information, would be to have all documents classified as highly sensitive due to the difficulties of identifying in which level of classification they belong. This would in turn obscure the genuinely highly sensitive documents.

CSA recommends that if necessary companies put in place a process to identify and safeguard particularly sensitive documents, but that documents generally should be dealt with according to uniformly applied standards and processes of the company.

C3: Leak investigations

CSA recognises the possible attraction to ASIC of requiring companies to investigate a leak or suspicion of a leak, but is of the view that it is not always either feasible or of benefit to the company to undertake an investigation.

Many smaller companies do not have the expertise or resources to undertake a proper investigation. In many cases, an ineptly conducted internal investigation may in fact hamper any future external investigation or prosecution by ASIC or other regulatory or law enforcement agencies.

CSA notes that a company's reaction to a leak will, of course, depend on the circumstances and seriousness of the leak. For example, there is a substantial difference in the impact on the market of a leak, for example on the back page of a newspaper, that causes general irritation because the timing of the distribution of the information was not in the control of the company, and a leak to select individuals who engage in insider trading on the basis of the leaked information. While both leaks may breach the law or the listing rules, CSA submits that leaks which appear to lead to insider trading should be the foremost priority of investigative and regulatory activity.

Another example of a substantial difference in a leak is one that appears on the back page of a major newspaper and one that reveals the name of a bidder and the price offered in an asset sale. The seriousness of the leak will, and should, dictate the company response to conducting an investigation.

CSA recommends that a company should be required to put in place adequate measures to attempt to control employee actions in relation to the handling of confidential information, but that the regulatory guidelines should not recommend that companies automatically investigate all actual and suspected leaks.

C4: Umbrella agreements

CSA again recognises the advantages of companies putting in place umbrella agreements with their advisers, but notes that for a variety of reasons it may not be practical to do so in all cases.

It will only be possible to put in place an umbrella agreement with advisers with whom the company has an existing relationship. However, this will not always be the case. For example, an investment bank may approach a company in relation to a capital raising, having never worked with that particular company before.

CSA recommends that the guidelines do not suggest umbrella agreements as best practice for the reasons set out above.

C5: Confidentiality agreements

CSA recommends that all advisers be required to sign transaction-specific confidentiality agreements.

To effect this, **CSA recommends** that companies enter into standard confidentiality agreements with third parties, such standard agreements to operate at a high level and at the commencement of any transaction. A third party would be required to sign the confidentiality agreement in order to gain access to sensitive information.

The existence of a confidentiality agreement is a useful mechanism to remind all parties of their moral obligation to protect confidential information, as well as to ensure that there are binding legal obligations in this regard.

More detailed agreements may then be put in place, at the company's discretion, to provide for the particular issues attaching to specific transactions. That is, agreements may differ depending on the nature of the service being provided and the level of access to sensitive information granted to the adviser or service provider. The company is best placed to consider the time and cost of putting in place specific confidentiality agreements within the commercial context of a transaction.

For example, in an asset sale the potential for leaks could sit with the bidders, and therefore a different confidentiality process applies than to a capital raising, where the potential for leaks could sit with the investment bank. A confidentiality agreement with media and public relations advisers would need to be different from one put in place with legal advisers, as the particular requirements applicable to the provision of legal advice could place a media or public relations consultant in conflict with the terms of their contract with the company.

CSA strongly recommends that no category of adviser or other service provider be excluded from the requirement to execute a standard, high-level confidentiality agreement.

D: Individual obligations

D1: Individual confidentiality agreements

CSA is of the view that individuals should be reminded of their personal obligations, **and recommends** that all individuals involved in highly sensitive transactions should be obliged to sign individual confidentiality agreements (unless they are already subject to, for example, statutory and common law obligations of confidentiality as directors of the company).

CSA also recommends that it would focus the attention on the need to preserve the confidentiality of company information to require the directors of service providers, for example, an investment bank, to sign individual confidentiality agreements.

D2 and D3: Personal account dealing policies and controls

CSA contends that placing restrictions on employees with price-sensitive information trading in the company's financial products in a personal capacity should be welcomed and understood by honest employees. However, it is important to note that such restrictions cannot prevent dishonest employees from so trading and it is almost impossible for a company to monitor or detect the trading activities of employees who trade through nominees, shelf companies or other third parties.

CSA is of the view that the issues raised in this section of the consultation paper are already dealt with in most companies' trading policies. CSA has issued guidance on the matters that should be covered in a trading policy — the *Good Governance Guide: Issues to consider when developing or reviewing a policy on trading in company securities* is attached as Appendix A. CSA strongly recommends that a company's trading policy address trading by advisers and third parties in possession of sensitive information.

CSA also notes the proposal by the ASX to introduce a Listing Rule requiring all listed companies to have a trading policy in place. The Exposure Draft of this proposal is currently available for consultation, with submissions due to close on 26 February. CSA has made a submission on the Exposure Draft, which is attached.

CSA notes that a company is well positioned to develop and put in place a policy on trading in company securities, and to offer education on the terms of the policy to all appropriate employees. However, it is difficult for a company to monitor individual actions or enforce compliance with the company's policy, as individuals may trade under another name or through a third party, and the company would be unaware of such trading.

CSA agrees with the recommendation that firms in the financial services industry that advise on market-sensitive transactions should have personal account dealing policies in place.

E: Sounding the market

CSA is of the view that market soundings are an appropriate part of capital markets. They are important to the capital management of a company. It is not in shareholders' interests to undertake a capital raising without taking a sounding of the market, as they provide guidance on pricing and assist in maintaining shareholder value.

CSA notes that the consultation paper does not acknowledge the important role of market soundings, but tends to view them as problematic undertakings. CSA recommends that any guidance on handling confidential information should acknowledge the proper role that market soundings play in capital markets.

E1: Investment bank practices and procedures

CSA notes that an investment bank could be taking initial soundings of the market without the knowledge of the company and, indeed, it is quite usual for a company not to know that such initial market soundings are being conducted and not to be apprised of them in advance. The company does not have control of the investment bank's decision to take an initial market sounding.

Moreover, an investment bank could be sounding institutional investors that are not currently on the company's register, and could be approaching them as potential investors. The investment bank may wish to do this prior to approaching the company with a proposal.

CSA therefore sees the recommended best practice of an investment bank informing the company that it needs to sound the market and obtaining the company's approval to do so as highly impractical. **CSA does not support this recommendation.**

E2: Investment bank notifying ASIC within 48 hours of conducting a sounding

CSA strongly recommends against any requirement for investment banks to notify ASIC within 48 hours of conducting a sounding of the market.

CSA is of the view that this proposal oversteps the mark of ASIC's role as regulator. Even in a heightened continuous disclosure environment, there should be no requirement or expectation that company information should be provided to ASIC if there is no clear regulatory requirement to do so. CSA notes that ASIC has considerable investigative powers already, including the announced proposal by the government to expand the pecuniary penalties and investigative powers of ASIC in relation to insider trading offences. **CSA recommends** that ASIC's existing investigative powers should be utilised.

CSA recommends that it is good practice for a company or an investment bank to keep appropriate records whenever a market sounding is conducted. ASIC can ask for such records to be provided voluntarily at any time, or ASIC can use its powers under the ASIC Act to compel production of the records.

Draft Regulatory Guide

Our comments in this section relate to the Draft Regulatory Guide.

Information barriers and physical document management

CSA is of the view that the proposal on p 32 that companies should implement 'a clean-desk policy for those employees who are handling price-sensitive confidential information' is highly impractical. For example, it would be virtually impossible, during a capital raising held over two or three days, for a clean-desk policy to be applied.

CSA recommends that it is good practice for any employee to manage sensitive information carefully and recommends that how this is undertaken should be left to the company's discretion.

Information technology controls

CSA is of the view that the proposal on p 33 that companies operate 'an IT system that has the capacity for a full audit trail of who has accessed particular files and when the access occurred' has the potential to impose very onerous burdens on smaller companies which may not have the resources to install sophisticated document management systems.

CSA notes that, under the title of Regulatory Guide, such recommendations have the capacity to be read as regulatory obligations rather than as guidance. As before, CSA would prefer to see the ASIC best practice guidelines acknowledge the need to maintain proper processes for handling confidential information while also acknowledging that the practices relating to this require a subtlety of approach, as they may need to be tailored to various factors, such as the size of the company, the size of the transaction and the commercial realities of a transaction, which can proceed very rapidly.

Continuous disclosure regime

CSA is very concerned by the recommendation on p 34 stating that :

> A company must comply with its continuous disclosure obligations even if the quotation of the company's shares is suspended or subject to a trading halt (see Listing Rule 18.6). Companies and their directors should be cognisant that trading can occur on market other than the ASX and through over-the-counter (OTC) markets (such as the CFD markets), and the trading halt will not extend to those markets. Companies should also recognise the fact that a transaction in its securities may affect the trading of the company's peers and competitors.

A company has very little control over the management of continuous disclosure at a time when price-sensitive information is not yet ready to be disclosed to the market but there is speculation in the market. At such times, the only option available to a company is to call a trading halt. The paragraph above appears to indicate that ASIC believes calling a trading halt is insufficient to manage a company's continuous disclosure obligations. This conflicts with the introduction of the trading halt as the tool to allow companies to manage their continuous disclosure obligations at such times.

A company can only monitor and enforce what is in its capacity to control. A company cannot always prevent trading on other markets or manage secondary markets in any way.

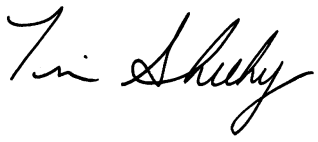
CSA strongly recommends that this paragraph be deleted from the final version of the Regulatory Guide.

Conclusion

In preparing this submission, CSA has sought input from its members through its national policy committee, the Legislation Review Committee.

CSA would be more than happy to arrange for ASIC to meet with our members to discuss the issues canvassed in this submission.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE