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10 November 2003

Mr Mike Rawstron
General Manager
Corporations & Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Rawstron,

CLERP (Audit Reform & Disclosure) Bill (CLERP9) October 2003

The Securities & Derivatives Industry Association (SDIA) is the peak industry body representing the interests of 69 stockbroking firms, which account for over 98% of market turnover in Australia. We very much appreciated the chance to meeting you in Canberra recently to discuss issues of concern to the industry.

On 20 November 2002, SDIA made a submission to Treasury on the September 2002 *CLERP9* policy paper addressing 2 issues of particular concern to the stockbroking industry, namely:

- **Research Disclosure**
- **Retail vs. Wholesale Investors**

After having reviewed the draft CLERP9 legislation, we would like to make the following comments on those areas:

1. **Research Disclosure & Management of Conflict of Interest** (Proposed paragraph 912A(1)(a) and *CLERP9 Commentary* Chapter 10)

As noted in our first submission, SDIA has been considering this issue since May 2001, and in November 2001, SDIA in conjunction with the Securities Institute of Australia, released its Best Practice Guidelines for Research Integrity (the "*SDIA/SIA Guidelines*").

The *SDIA/SIA Guidelines* set out 10 principles for best practice in research:

1. Putting the Interests of Investors First
2. Establishing Separate and Distinct Reporting Structures
3. Having Chinese Walls to Prevent Dissemination of Information
4. Disclosure of Interests
5. Restriction on Trading
6. Remuneration Should not be Directly Linked to Revenue
7. Investment Recommendations Should be Unambiguous

8. Dissemination of Research
9. Statement of Firm's Policies and Procedures
10. Monitoring Compliance with Firm's Policies and Procedures

A survey of our members in 2002 showed substantial uptake of the *SDIA/SIA Guidelines* in stockbroking research departments.

We are pleased that the Government has preferred to maintain a principles-based approach to regulation of this area. As we have noted previously, there has not been the same level of problems in this area as there has in other jurisdictions, particularly the United States. This point has recently been confirmed by a review of procedures by ASIC¹.

The Government proposes to add a further license condition to licensees requiring them to:

...have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative.
(proposed paragraph 912A(1)(a))

This new condition is aimed at supplementing the existing requirement for licensees to act "efficiently, honestly and fairly". As sought by ASIC, it provides stronger legislative basis for ASIC to give policy guidance and take enforcement action.

In October 2003, ASIC released a draft policy proposal concerning its interpretation and enforcement of the new provisions² and we look forward to working with ASIC on its new policy.

SDIA supports the new provision.

2. Retail vs. Wholesale Investor Definition *(Commentary page 5)*

In our earlier submission, we outlined the varying definitions in the Corporations Act regarding the definition of retail and wholesale investors. This variation in a concept that ought to be uniform leads to serious problems in the application of the provisions across our members' businesses.

*From a practical perspective, what this means is that the "sophisticated investor register" which many broking firms currently maintain (based on the s708 criteria) will need to be split into two, or even three, separate registers. Care must be taken to ensure that the right register is used, depending on the correct characterisation of the relevant financial product. It also means that although one client may be "wholesale" for one purpose, they are not for another – though there is no apparent reason why this should be so.
(SDIA Submission on CLERP9 dated 20 November 2002 page 4)*

Accordingly, we are disappointed that while there is in-principle support for the alignment of the varying definitions of retail and wholesale clients, the proposal is not being advanced in CLERP9 at this stage.

¹ Australian Securities & Investments Commission *Research Analyst Independence – ASIC Surveillance Report 22 August 2003*

² Australian Securities & Investments Commission *Licensing: Managing conflicts of interest (with specific guidance for providers of research reports) - ASIC policy proposal October 2003*

We are particularly disappointed that one of the reasons why it is not being advanced is:

- *to gain better informed comment and analysis on how to progress this proposal through greater experience with both the sophisticated investor and wholesale client test in practice*
(Commentary page 6)

As outlined in our previous submission, we believe that the problems of the disparity in definitions are already well known from practical experience. Our members have had to grapple with these differing definitions since at least 1998. We reiterate our submission that the distinctions identified are unworkable and appear to have no clear philosophical justification. We trust that the anomalies are addressed by legislative reform in the near future.

SDIA appreciates the opportunity to comment on this important package of legislative reforms. If you would like to discuss the matters raised in this letter in greater detail, please contact me or Doug Clark, Policy Executive on dclark@sdia.org.au.

Yours sincerely,



David Horsfield
Managing Director/CEO

cc. Mr Michael Rosser – Department of Treasury
Ms Pauline Vamos & Mr Mark Adams - ASIC
Ms Christine Jones & Messrs David Lawrence & Shaun Nicholls – ASX