ASIC
Australian Securities & Investments Commission

ASIC's perspective on resources and reserves reporting

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ASIC's strategic framework

To set the scene for my comments today I quickly want to mention ASIC's strategic framework and how the work of the Commission is focused on three key priorities. The first of our three priorities is to ensure confident and informed investors and financial consumers.

In this regard we are focussed on:

- recognising how investors and consumer make decisions which may affect them financially,
- educating investors to improve their understanding of relevant concepts in investment; and also
- holding what we refer to as 'gatekeepers' to account. Gatekeepers are essentially those intermediaries who are involved in providing investors with the information they need to navigate the financial world – so this extends not only to directors and auditors, but also to experts such as Competent Persons.

Our second strategic priority is ensuring fair and efficient financial markets. We seek to achieve this through our role in monitoring and enforcing laws relating to market disclosure and integrity and also through our market supervision role. And our third priority is ensuring efficient registration and licensing with a particular focus on small business.

ASIC's interest in resources and reserves reporting

Given the first two strategic priorities mentioned, it's probably not surprising ASIC has had a keen interest and involvement in the most recent updates to the disclosure regime for mining and exploration entities embodied in the Australian Securities Exchange (ASX) Listing Rules and the 2012 JORC Code [The Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves]. This naturally reflects the role the Code and Listing Rules play in ensuring the integrity of our financial markets.

At this point it is worthwhile explaining how important the Joint Ore Reserves Committee (JORC) is by reference to historical events.

The JORC Code has its origins in the wake of the 'Poseidon boom' of the late 1960s to early 1970s. Poseidon Nickel was a mining exploration company that made a nickel discovery at Windarra in Western Australia in 1969. It issued a report saying that the company had struck significant deposits of nickel – but the report was based on geological information arising from incomplete and inaccurate figures using a process that was inappropriate for the particular find. The geologist who prepared the report was also indirectly a major shareholder in Poseidon. Prior to its collapse,

the share price of Poseidon leapt to reach an intraday peak of $280 a share on 5 February 1970, representing a 35,000% increase on the issue price and giving Poseidon an overall market capitalisation that was one third of that of BHP.

The rise in price of Poseidon and some other mining companies around that time was due predominantly to rumour, speculation, false reporting of mining results and insider trading, which was not illegal at that stage. The excesses of this spectacular boom and bust resulted in a public outcry and a Federal Government Senate Select Committee looking into Australian securities markets and their regulation. That report led to the creation of what is now ASIC and provided the impetus for guidelines and later a code about the reporting of minerals – what we know today as the JORC Code.

Today, over 40% of the entities listed on the ASX are resource companies. In many respects the share price and value proposition of most of these entities are largely, if not entirely, a function of the tenure, quality and prospectivity of their mining tenements. This means disclosure about the mineralisation in these tenements is highly material. So it is imperative to ensure these disclosures are soundly based and that the presentation of this information does not mislead. And this of course is what the specific disclosure regime for mining and exploration companies in the JORC Code and the Listing Rules is all about.

A principal interest of ASIC in all of this is ensuring that the whole regime is consistent with relevant requirements of the Corporations Act that investors receive quality information and are not misled.

ASIC comes across these reporting issues most frequently in the course of its everyday regulatory role in reviewing and monitoring disclosures in documents lodged under the Corporations Act including prospectuses, bidder's statements and schemes of arrangement. All of these are public reports to which the JORC Code and, in the case of ASX listed entities, the Listing Rules, apply if the documents contain relevant discussion regarding mineralisation.

Today, I'd like to talk about some key things that we have been focussing on in the mining and exploration space for some time now and how they overlay and complement the JORC requirements and listing rules.

General disclosure principles

We focus on some general disclosure principles in doing our work. These are common sense things that you should remember:

- **Context**: we don't look at the documents lodged with us in a vacuum and suggest that neither should you. In monitoring a transaction we

review various sources of information including ASX announcements, broker reports and media to get an understanding of the background information investors have been receiving about the company. Expect questions if all the pieces of the puzzle don't quite fit together.

- **Underlying assumptions**: people can't weigh up the reliability of how you see future events unfolding unless they know in sufficient detail why you hold your views.
- **Reasonable basis**: under the law you can't just make predictions about what will happen in the future without having a reasonable basis for it. That means something more than a simple passionate belief in the future of a project.

All of these issues are typically relevant when forward-looking statements are made about mining or exploration companies. Often, disclosures are being made about the prospectivity of assets which are speculative in nature. These disclosures are of particular concern as they typically involve positive headline figures and conclusions; are sometimes light on detail and are often made in the context of a pending or current corporate action such as a takeover or fundraising.

Forward -looking statements

ASIC is particularly focused on forward-looking statements. As just mentioned, there is a general principle of consumer protection (which is replicated in the Corporations Act) that statements in relation to future matters must only be made where there is a reasonable basis for making those statements.

This requirement and its underlying policy is really at the core of a lot of the work ASIC has been doing in the mining and resources space. The new listing rule requirements relating to mining production targets are a good complement to this because, in many respects, they codify the application of the basic principles for mining and exploration disclosures.

The classic case of concern for ASIC is the hypothetical estimate of raw production or the future economic value of production – for example, companies making predictive and investment-inducing statements about future matters such as production targets or financial forecasts where these statements are not backed up by a sufficient level of resources and reserves.

Although some time ago now, the case of ASC v McLeod provides a good example of the issues of concern ASIC still raises with mining and exploration entities today. Just briefly, McLeod involved a recently-listed diamond exploration company, Cambridge Gulf Exploration NL, which was exploring the sea bed off the far north of Western Australia. The company

had commenced a bulk sampling program and shortly after announcing that gem quality diamonds were being recovered there was a share price rise. After the price rose from 88c to $2.05 ASX suspended trading pending the delivery of a statement regarding the exploration results.

Mr McLeod was engaged to produce the report required to have the suspension lifted. His report set out the company's exploration results but then went on to outline a conceptual alluvial mining plan incorporating a processing plant with a 4000t per hour capacity and a projected profit figure.

The WA Supreme Court upon appeal found that the Macleod report was misleading:

- firstly because it suggested the company was at the time in a position to advise members of the investing public of results on which they could rely, even though the sample size was not sufficient from which to assess whether diamonds were present, and
- secondly because it suggested the company could achieve significant profits from mining operations notwithstanding its figures were extrapolated from small sample of insufficient certainty.

The court found the probable result was to induce a reader to act in the belief that the company both had a basis for making a prediction of the profitability of the venture and that profits would arise. The report was therefore materially misleading. The case highlights that a reasonable basis is required to support forward-looking statements and there needs to be sufficient disclosure to meet the expectations of the average investor. Production targets, whether relating to minerals or energy, require a reasonable basis under the law. And it's really when you are talking about mineralisation at the lower end of the disclosure scale, in which there is a low level of confidence, that concerns are at their highest.

This is where the new ASX Listing Rules provide some more specific guidance. The new Listing Rule 5.15 prohibits production targets that are:

- based solely on an exploration target, or
- based on a combination of an exploration target and inferred mineral resources, or
- based solely or partly on historical estimates or foreign estimates (other than qualifying foreign estimates).

There are also a number of new rules relating to production targets which extrapolate inferred mineral resources – including a requirement for disclosure by the company of the factors giving a reasonable basis for the statement; the requirement of an independent competent person's report where a production target is solely based on inferred mineral resources; and cautionary statements.

As noted in ASX Guidance Note 31, it is only in exceptional circumstances that any entity is likely to be able to form the view it has reasonable grounds for production targets etc where it has only inferred resources. In essence this is limited to types of mineralisation where the project cannot be progressed through to a higher confidence level by conventional exploration alone prior to release of a production target.

The international context

So, overall, ASIC endorses the recent updates in the JORC Code and the revised Listing Rules. The regime keeps Australia apace with our competitors for the investor dollar in the major mining economies of Canada and South Africa. Without these revisions Australia was in danger of being left behind in the disclosures stakes, with resulting adverse impacts on our cost of capital.

The mandatory disclosure of Table 1 of the JORC Code for ASX listed mining companies on an 'if not why not' basis provides much improved transparency of the assumptions that underpin exploration targets, resources and reserves – with subsequent material changes to these numbers also requiring disclosure of Table 1. Further, the definition of the different levels of mining studies, in line with the international definitions, aligns studies in Australia with studies completed in other jurisdictions. This is vital in the global market.

And on the oil and gas front, the formal incorporation of the SPE PRMS (Petroleum Reporting Management System) in the ASX's listing rules as a reporting framework provides clarity. Many energy companies in Australia already use the PRMS. The inclusion of the PRMS provides clarity to investors about the risks and assumptions that underpin reports by energy companies about their prospects as expressed in terms of resources and reserves.

If things go wrong

And to finish off on a cautionary note, ASIC as the regulator has a number of tools at its disposal to apply as the regulatory situation requires. Timely action on ASIC's part is our most effective tool for ensuring market integrity, and this action comprises a blend of education, intervention and, if necessary, enforcement.

Action on ASIC's part is mostly achieved using our administrative tools, or when documents or applications are lodged with ASIC. Disclosure deficiencies are generally dealt with by seeking additional or clarifying disclosure, ensuring investors and financial consumer can make informed decisions.

We also employ civil and criminal proceedings, but less frequently as these can be lengthy and in the mean time the market moves on. If you are interested in our enforcement approach generally, further information is described in our Information Sheet 151 *ASIC's approach to enforcement* (INFO 151).

In conclusion, ASIC welcomes the recent changes to the JORC Code and ASX Listing Rules, continuing the tradition started after the Poseidon case of effective industry-based regulation. As the Poseidon case reminds us, it is critical for these rules to operate effectively and that does mean adapting as the market grows and evolves.