MAJOR CHALLENGES IN FINANCIAL REGULATION AT THE END OF THE DECADE

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Outline

It is now just over 5 years since I was privileged to present the Monash Law School Foundation lecture on 12 April 1994. I observed at that time that all of my predecessors among the Foundation lecturers were men, and I am therefore pleased to observe that that gender imbalance has long since been appropriately redressed.

I thought therefore tonight, that it might be appropriate to look again at what I had said 5 years ago, in what I believe was this very room, and then to highlight some of the issues which are major issues in 1999, but some of which were not on the agenda back in 1994, and indeed, may not have been in anybody's serious contemplation.

Law enforcer and business facilitator - enforcing accounting standards

The main theme of my presentation in 1994 was the twin roles of the then ASC as both law enforcer and business facilitator. At that time, I was seeking to ensure that the ASC's enforcement responsibilities, and the prominence they then attracted and continue to attract in the media, should not distract from an appreciation of the importance of the ASC's other role as a business facilitator. Even when we were enforcing the laws, by prosecution, or civil action, or disciplinary action against a licensee, we were simultaneously facilitating business, by encouraging potential investors to believe that it was worthwhile taking sensible business risks. I attempted to give these propositions some substance by discussing the affairs of a public listed company, called Cameron Securities Limited, which I suggested you would correctly deduce was a fictional company. I derived the inspiration for it from a book written by Peter Corris about the bidding process for the then equally elusive concept of a Sydney Casino. Sadly for both Peter Corris and me, this particular invention is no longer entirely fictional, as there is a company called Cameron Securities Limited, with which I have no connection at all, which is a prominent Sydney based securities dealer. Truth is once again catching up with some aspects of fiction.

In my 1994 speech, I suggested that the mythical company Cameron Securities Limited had an accounting issue of some consequence, arising from its treatment of research and development expenditure in its accounts. I suggested that the company had, on the advice of their accountants, treated the license to undertake research and development on behalf of a syndicate as an asset in the accounts, but treated the corresponding obligation to make the payments to fund the research and development, as a contingent liability. This would have contravened what the ASC considered to be the correct analysis of Accounting Standard 1018. Since this would now be a contravention of the law, what would the ASC's attitude be? I answered this question in the following way:

"The ASC is not concerned to take draconian action against directors relying on proper professional advice about financial reporting obligations. I am referring to advice proffered and relied on, that is provided in good faith with the intention of facilitating compliance with the law. I am not referring to advice obtained from compliant advisers. Seeking and then relying on the advice I am referring to, represents a legitimate endeavour to comply by the clients. Opinion shopping is the opposite. In the circumstances I have described, the ASC is primarily concerned to correct errors and inadequacies in the financial statements. This is usually achieved by one of us seeking declarations from a court as to the appropriate treatment if we and the company cannot agree. If our interpretation of the relevant accounting standard is challenged in a court we will welcome that, but I should tell you that we have not yet lost such a case."

I would suggest to you that we have been consistent in that policy since that time, and continue to have lost remarkably few cases since then. I produce as evidence in support of that former proposition, the ASIC proceedings against Media Entertainment Group Limited, the settlement of which was announced earlier this week. These proceedings were commenced because ASIC believed that the amounts due to the company under contracts for the provision of advertising services, were not permitted under the relevant accounting principles to be recorded as revenue until the services had been provided. ASIC therefore concluded that MEG's recognition of revenue immediately upon the signing of the contracts, for services that would be rendered several years into the future, did not give a true and fair view of the financial position and performance of the company.

As I said in 1994, the contravention of accounting standards is technically a breach of the law, but ASIC is primarily concerned in most such cases to ensure that the law is complied with, and that doubt is removed by an appropriate decision of the Federal Court. In one sense, but only in one sense, that intention has been thwarted on this occasion, by MEG belatedly agreeing with ASIC to settle this matter on terms that will ensure that it distributes to its shareholders revised financial statements prepared in accordance with ASIC's interpretation, and further that future financial statements will similarly be prepared in accordance with that interpretation. MEG will also be paying ASIC's costs of these proceedings.

As our Chief Accountant, Jan McCahey, said at the time of the settlement, the accounting standards are designed to promote consistent and comparable financial reporting, and ASIC is prepared to litigate to enforce accounting standards where it believes that a failure to comply may result in the market being misled. The terms of settlement effectively achieved the same outcome as fighting the case.

I should interpolate at this point that the then ASC decided to test the proposition that what the market really wanted from its regulator was enforcement; in the best tradition of such research, the independent market research we started that year and have repeated on a regular basis every 2 years since, has confirmed that perception, but we want to be respected for our judgements of when and how the law is enforced, rather than feared because we enforce the law blindly and harshly, irrespective of the commercial consequences, and we still understand that our role remains mixed, not simply to be the policeman.

Business judgements

I then turned in 1994, to the issue of fostering a climate of compliance, and referred to the belief that there was a fear in the market of "regulatory rear vision". I was referring in that inelegant phrase, to the perception that the regulator views and judges the conduct of those who fall within its field of vision, including directors and company advisers, with the benefit of hindsight. I sought to provide assurance that neither the law, nor the ASC, endeavour to regulate or prevent unsuccessful business decisions, such as binding directors and their advisers to profit forecasts that, for reasons could not reasonably have been foreseen and disclosed in a prospectus, are not achieved.

In 1999, we are in exactly the same position. Neither the law nor ASIC is attempting to second guess business judgements of directors. What has changed, of course, is that the government has decided to make that message even clearer by legislating, in the current round of corporate law reform, for the enactment of a statutory business judgement rule to put that matter beyond any doubt. ASIC is comfortable with that outcome, and also welcomes the corollary, namely the introduction of the statutory derivative action in order to provide a private alternative to the section 50 proceedings which it can bring in appropriate cases on behalf of shareholders or companies.

Enforcement powers

In April 1994, the Commission's enforcement powers had recently been the subject of consideration by a Senate Committee then known as the Cooney Committee, but renamed as the Ellison Committee prior to its report being delivered some months later. In my speech, I mentioned various matters of law reform with which I hoped the Committee would deal, including some which still remain outstanding today such as the admissibility of records of examination in that form, the desirability of uniform evidence laws, and management disqualification orders, but several others are of some particular interest. One of these was the desirability of ASIC having the power to accept enforceable undertakings. It took several more years, but on 1 July 1998, ASIC obtained that power as part of the package of law reform by which it also acquired its new name and added responsibilities.

The enforceable undertakings power is now a major weapon in our armoury, and has been used to a considerable effect in matters such as the wrangle with Crown Casino Limited about its continuous disclosure practices last year, and even to support the decisions of the Federal Court of Australia in the litigation brought by the Commission against Nomura in which that large Japanese investment house was found to have manipulated the Australian stock market. I will come back to both of these matters in due course, but mention them now simply to emphasise that, without the enforceable undertaking weapon, the detailed compliance procedures adopted and now being used to great effect by Crown Casino Limited, and the compliance procedures adopted by Nomura, would not only have required judicial time for their adoption, but would also have potentially been regarded as too detailed and therefore inappropriate for court orders, even by way of settlements.

Limitation period

A further matter referred to at that time was the limitation period of 5 years for corporate crime. I argued that the 5 year limitation period was inappropriate for corporate crime, by reason of the very nature of corporate crime and probability of documentary camouflage, which meant that it often escapes early identification despite the best endeavours of our surveillance programs. The Parliamentary Joint Committee on Corporations and Securities has subsequently accepted the proposition that section 1316 of the Corporations Law should be omitted, but this recommendation has not yet been enacted. Meanwhile, as you would know, the ministerial decision to grant consent to a prosecution under section 1316 of the law in the case of Mr Oates, a former director of Bond Corporation Holdings Limited, has been successfully challenged in the full Federal Court, and an appeal to the High Court is pending.

New players on the field - new rules in takeovers?

I concluded my 1994 address by suggesting that ASIC's role can be equated, to some extent, to that of the referee in a football match. Like the referee, ASIC is concerned to allow the market to operate as free from stoppages as is possible. That continues to be the philosophy which we apply, particularly in complex disputes between well heeled players over matters such as takeovers. However, as some of you may have heard me say at a recent presentation in a new series entitled *ASIC Speaks*, on the particular subject of takeovers, the ground has rather changed in 1999. Contrary to the trend in all of the codes of football, the players now include far more amateurs and people with little experience of the subtleties, far less the rules, of the game.

I am referring to the phenomenon of popularly held companies. Starting with the privatisations of the early 90's, through to the demutualisations of the major insurance companies towards the end of this decade, we have seen a dramatic explosion in private direct shareholding in Australia, to the extent that we may well now be the second ranking country in the world in terms of private participation in our stock market. Something like 40% of adult Australians now directly hold shares in Australian companies. But many of these people do not necessarily understand the rules of the game as the professionals do. For example, until recently, if an advisory firm acting for Target Company Limited wanted to ensure that it could apply maximum pressure on the bidding company, and its advisers, to extract the best price, strong language would be used in the material issued to shareholders such as, **ignore all the documents sent to you by Rapacious Bidder Limited**. Similarly, in order to increase the pressure on the unsuspecting shareholders to accept the offer, Rapacious Bidder Limited would frequently say things such as **our bid is to close on 30 April - get your acceptance in now**.

Those who were the traditional shareholding classes until recently, understood that you were not literally to ignore the document or throw it away, and the offer would only close on that date if it was not extended before then. ASIC believes that the assumption that shareholders generally understand what is really meant in such situations, is no longer valid. Popularly held companies have shareholders numbering in the hundreds of thousands, and bidders, targets, and their advisers must understand that ASIC, and we believe the courts, will hold them to a higher standard of disclosure in future.

ASIC believes that its obligations in this respect are heightened because of its additional role, since 1 July 1998, as the consumer protector in the financial sector. We believe that the inference which we should draw from this additional role is that we should if anything be more assiduous in future in protecting the interests of investors with respect to statements in takeover contests which may be misleading or deceptive. If you mean that your offer is scheduled to close on a particular date, then you must say that. If you say that your offer will close on a particular date - no qualification, then ASIC is likely to regard you as having engaged in misleading or deceptive conduct if you purport to extend it.

Lest you think that the Commission is changing the rules and not letting people know, I should say that the series of presentations made in March and April by me and ASIC's National Takeovers Co-ordinator announcing this policy were attended by 200, 130, and 80 people respectively, in Sydney, Melbourne and Brisbane. We believe we have sent that message, and will now be seeking to enforce it.

What's Hot in 99

That brings us then to the issues which are the big issues in 1999. Under this heading, there is a lot to choose from, including the demutualisation and self-listing of the Stock Exchange, the new responsibilities of ASIC with respect to market integrity and consumer protection relating to deposit taking (banking), insurance and superannuation, the increasing emphasis we now place on investor and consumer education, the vexed issue of analysts' briefings, the saga of corporate governance, and other aspects of corporate and investment life today. Each could justify a lecture on their own account, but let me venture a few words on each.

ASX

The demutualisation and self-listing of the Australian Stock Exchange has attracted considerable world-wide attention and interest. The current proposals to demutualise the Sydney Futures Exchange and then merge it with the ASX, if they should succeed, would to some extent be following some trends which are established overseas, in terms of linkages, alliances and mergers, but the Stock Exchange exercise is undoubtedly ground breaking. The regulatory issue raised, and which may be compounded if the merger with the SFE were also to proceed, is whether the present regulatory structure will be appropriate long term for a privately owned and traded stock market.

To a considerable extent, the assumptions which underpin the self regulatory model and the legislative framework in the Corporations Law for the Stock Exchange, are still based on the concept of a professional association of stock brokers imposing a form of self discipline upon their peers. With the total disappearance of floor trading, and now the separation of ownership of the market from the right to operate on that market, those concepts do not appear to have any place at all. The Government's Corporate Law Economic Reform Program paper No. 6, dealing with financial products, service providers and markets, does look at some of these issues, and it will be interesting to see whether the submissions in response to that paper reach a consensus as to the future of the present regulatory model. The dramatic rise in the share price of ASX Limited has increased the pressures upon ASX to deliver in terms of profits, which must in turn put pressure on their regulatory spending.

New roles

ASIC's new roles with respect to deposit taking, insurance and superannuation are hopefully now reasonably well known. What did not receive much attention until very recently was the fact that ASIC and its sister regulator, the Australian Prudential Regulation Authority, are funded for their new responsibilities by way of a special levy imposed on banks, other deposit takers, insurance companies, and superannuation funds. In dollar terms, the amount raised by the levy for the purposes of ASIC, compared to the dollars spent by ASIC on other activities, is not great - less than 10%. But in accordance with the scheme under which the levies are created, the levies are applied to the various institutions according to their traditional characterisations.

This, in a sense, runs counter to the Wallis philosophy of regulating by function rather than institution, and that is in itself a concern. But more than that, ASIC is concerned that a focus on the amount of these levies and the way in which ASIC devotes its attention to the different kinds of financial institutions, will cause it to behave inappropriately, to direct its activities based on having to spend money on work according to institutional distinctions, rather than based on a risk assessment made from time to time across the full range of the financial sector.

High risk, high return investments

ASIC has designed some of its activities specifically to draw attention to the risks associated with high return investments. These activities started some time ago, when as a result of the Good Advice research project undertaken into the standards of investment advice, ASIC became increasingly concerned that there were many people out there who were not dealing with licensed investment advisers in any event, and for whom therefore, ASIC's work in improving the competencies of such advice, and the reliance which clients could place upon the advisers, was simply going to be ineffective.

Last year, we ran a specific campaign in Western Australia directed at people working in remote mining communities, who were frequently the targets of aggressive marketing of high return investment schemes; we also ran an April Fool's Day campaign based upon advertisements we lodged ourselves, drawing attention to highly unlikely investments (this campaign won the Public Relations Institute Award for the best public relations campaign in the financial services area); and we published our first book for a general market, Scams and Swindlers.

This year, as you may have heard, we again perpetrated an April Fool's Day hoax upon an unsuspecting community, this time, virtually world-wide which offered the opportunity to invest in millennium bug insurance complete with fake web site, **www.smbi.com.au**. The fake internet investment site raised $4.2 million. People were told that it was a sure thing that they would triple their money in 15 months if they invested in the company Millennium Bug Insurance. The "company" supposedly offered blue chip companies insurance against losses from the Year 2000 Millennium Bug.

We are totally unapologetic about this initiative. Among other things, we are intending to send a message that ASIC is itself a risk taker. We encourage business people to take risks, sensible, defined and explained risks, but we also are prepared to be risk takers ourselves, in the cause of drawing to people's attention, the fact that they are gullible, and need to be careful or they will risk losing all of their investment to fraudsters. Whatever view might ultimately be taken about the success that governments might have in controlling other undesirable material on the internet, the fact is that the first and best protection for people from losing money to fraudsters, is to increase their own awareness of the risk that they might be the victims of fraud and to encourage them to look after their own interests.

We often suggest, in response to the obvious question how do they protect themselves, that the public should insist upon receiving a prospectus. I should assure you that we are well aware that this is an incomplete answer. Obtaining a prospectus is unnecessary and impossible in the case of those investments which genuinely do not require them - and the range of those will jump if the CLERP bill presently in the Parliament is enacted; but importantly, the prospectus must still be read and understood before an investment decision is made. The myth that a prospectus registered with ASIC has somehow been blessed and approved by that process, and is "safe", is still too prevalent in our community.

These dangers are magnified by the increasing use of the Internet to trade shares, to display prospectuses and to dispatch information to shareholders. Warren Buffett states his motivation for using the Internet in the 1998 Berkshire Hathaway Annual Report:

> *"We want to make Berkshire's information accessible to all of you simultaneously. Our ability to do this is greatly helped by the Internet."*

Selective Disclosure

The past decade has witnessed more explosive growth in our markets and more rapid technological change than at any other time in history. At the beginning of 1989, the All Ords hovered in the 1500 range. In April 1994 it was 2095. At the beginning of April 1999, the All Ords broke the 3000 barrier for the first time in history. Record numbers of individuals have shown their faith in our markets by putting more money in stocks and securities than ever before. [1]

This is partly due to a rapid and fundamental change in Australians' attitude to investment. Traditionally, we regarded banks and real estate as the only places to invest our savings. Until the start of this decade, the number of Australians who thought the stock market was the wisest place to invest averaged less than 4 per cent. At the end of last year it was more than 28 per cent, which was the highest of any investment category.[2]

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[1] The Dow Jones in April 1994 was 3681, and in April 1999, 10,886.
[2] ASX Media Release, 20 April 1999

I believe this surge in investment in the stock market reflects Australian's trust and confidence in the efficiency of the market, and that trust stems from a belief that ASIC relentlessly pursues its new mandate (since 1 July last year) to:

> *"promote the confident and informed participation of investors and consumers in the financial system."*[3]

A serious threat to the efficiency of the stock market and the confidence of market participants are directors, institutions and individuals trying to 'beat the system', by trading on price sensitive information in the search for a quick dollar.

Insider trading cases have, historically, been difficult to prove, partly because of the high threshold tests in the Corporations Law. In the 80's a successful insider trading prosecution depended on demonstrating that there was some sort of fiduciary relationship or duty of care between the company whose shares were being traded and the person doing the trading.

By the start of the 90's, no convictions for insider trading by market participants had been secured and, amid considerable political pressure for tougher laws after the 80's boom and bust, the law was toughened up. The fiduciary link was abandoned and insider trading became what we know it as today. That is share trading based on information not in the public domain which, if it were public, would have affected the price of the share in question.

We are aware of the perception in the market that the regulator does little, if anything, about insider trading and because of this, we have concentrated on this area, and we have taken some significant criminal and civil actions, including several convictions, and several civil recoveries of losses suffered by other investors; several major trials are also pending.

However, I'm concerned about one, increasingly worrisome form of trading on the basis of non-public information. This is material gathered from private briefings by listed companies for stock analysts. ASIC is watching this situation very closely, and we hope that self-restraint will solve the problem, before we have to step in.

This form of trading is not just a domestic problem, indeed my counterpart at the US Securities Exchange Commission, Mr Arthur Levitt, stated in November of last year:

"the selective disclosure of information by companies to stockbroker analysts is ethically wrong, cheating and a stain upon our market"

Disclosure in the Australian market is primarily dealt with by the ASX's continuous disclosure regime, which has the force of law and requires companies to report anything they believe could move their share prices. However, market sensitive information could also result from the incremental accumulation of information at analyst briefings that, taken by itself, may not appear to be caught by the continuous disclosure rules, but when added to other information obtained in other ways, may be price sensitive.

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[3] ASIC Act 1989, subsection 1(2)(b)

A recent case that triggered ASIC's interest in the information flow between companies and brokers was the referral by ASX to ASIC in 1998 of Crown Limited for a perceived breach of the continuous disclosure provisions of the Corporations Law. This concluded, as I mentioned earlier, with Crown providing an undertaking to us about how it would release information to the market in the future. That has enabled it to re-build market confidence in its disclosures, and ASIC has noticed press comment to the effect that unofficial briefings to selected analysts in the casino sector in particular, not just with respect to Crown, have dried up. So they should.

We recognise the important role that analysts play in our markets, and we encourage legitimate research as tending to increase investor confidence. Nevertheless, ASIC is concerned about selective corporate disclosure of material information to favoured analysts prior to public disclosure and the resulting threat to market fairness when the favoured few can trade prior to public disclosure.

The result can be what looks like unusual trading in the company's stock. It is clearly wrong for those who have received this information to trade before the public announcement, or to tip off their friends, or their family members, or their colleagues in their firms. Calls and briefings to analysts should not come before a press release, and that, even then, these discussions should not divulge new material information not contained in that press release.

Warren Buffett, in his 1998 Annual Report to the Shareholders of Berkshire Hathaway commented on the disparaging nature of these briefings.

> *"Today, many companies matter-of-factly favour analysts and institutional investors in a variety of ways that often skirt or cross the line of unfairness. These practices leave the great bulk of shareholders at a distinct disadvantage to a favoured class."*

Ethically, it's very clear. If analysts or their firms or associated fund managers are trading, knowing this information, and prior to public release, it's just as wrong as if corporate insiders did it. Securities firms are supposed to have Chinese Walls in place to stop the spread of such data. However, when we see trading spikes in this short time period, I worry about the effectiveness of those internal mechanisms.

Our markets are strong because investors are confident of their basic fairness. Trading on inside information, and giving early tips to other potential traders, damages the entire structure of our markets, because it disturbs this vital investor confidence. It can especially demoralise individual investors.

ASIC is interested in finding ways to ensure that the market is well informed and that individuals are able to make their own investment decisions and get proper advice. Good advice requires analysis. We are seeking to encourage a reasonably informed market where there is, therefore, less risk of insider trading and other undesirable practices. Analysts should reap their rewards from their analysis of information, not from their having such specific pieces of information which others do not have and cannot get.

We will look at providing some guidance to the market as to best practice in this area, perhaps for companies to ensure that contacts, whether with fund mangers or analysts are monitored internally but by someone other than the executive giving the briefing, to ensure that any price sensitive information which has emerged from the discussion is then disclosed more generally; further, that the contacts with analysts are not just one on one and the formal briefing is simultaneously made available to the Stock Exchange and on the home page of the company. It is sometimes said that the risk these days is of information overload; let's use the technology to test that point.

Corporate Governance

The 1990's has brought a more intensive focus on effective corporate governance. Corporate governance affects the relationships between the major players - the board, management, auditors and shareholders.

When a corporation finds itself in trouble, it often becomes clear that the board didn't fully discharge its responsibilities. What is obvious in hindsight, can be avoided through foresight. In practice, this simply means that boards must be equipped with an effective system to monitor management.

Corporate governance issues were recently highlighted in our investigation into the $700 million writedown of Burns Philp's herb and spice assets and the collapse of the Spedley group of companies. These reports prepared by ASIC are public documents[4] that can be obtained from our web site.

The aim of these reports is to provide guidance on issues which should be addressed to achieve effective corporate governance, and to provide a reminder that the continuous vigilance of directors, management and auditors is necessary to maintain a high standard of corporate governance.

ASIC believes that there is a public interest in publishing its findings, to draw a number of corporate governance issues to the attention of all participants in Australian markets.

Burns Philp & Company Limited

In 1998, ASIC commenced an investigation to determine the circumstances of the 1997, $700 million write-down of Burns Philp's herbs and spices assets.

The ASIC inquiry and investigation raised serious issues about the adequacy of the steps taken by the board of Burns Philp to ensure the accuracy of the reported value of the herbs and spices assets, and about the corporate governance practices of the company. Indeed, the outcome of the inquiry demonstrates the more subtle and complex corporate governance issues prevalent in the 90's than the 80's.

[4] These can obtained from ASIC's Homepage at *www.asic.gov.au*

The investigation suggested that there were substantial problems in the herbs and spices businesses of Burns Philp well before the sales process and writedown. The Burns Philp report found that, *"while the board recognised problems in 1996, it appears that the action taken by the company's directors was neither sufficient no far-reaching enough to remedy the deficiencies."*

The report then goes on to state that, *"earlier and clearer recognition of the problems might have allowed remedial steps to be taken which could have avoided the drastic write-down in 1997."*

The impact of the problems were reflected in the share price. In mid 1995, Burns Philp shares were selling for $3.49. With the September release of the 1996 Annual Report, the shares were trading at approximately $2.00. After the announcement of the proposed sale of the herbs and spices businesses in May 1997 the share price fell to $1.70. After the announcement that the herbs and spices businesses could not be sold, the share price fell to $0.18. While many factors influence share price, the falls relating to these specific events show substantial losses to shareholders.

Despite these serious issues about the then corporate governance practices of Burns Philp, ASIC concluded it would be inappropriate to commence any legal proceedings.

Corporate governance lessons derived from the Burns Philp report include:

- directors are responsible to ensure that the board functions effectively;
- directors are responsible to ensure they are appropriately informed about business performance;
- directors must question and evaluate key features of intangible asset valuation reports;
- directors are responsible to ensure that shareholders are appropriately informed; and
- auditors must question and evaluate material intangible asset valuations.

Spedley Securities Limited

The investigation into Spedley Securities Limited and related companies commenced in 1989 following the failure of the Rothwells group. Spedley and associated companies had significant exposure to Rothwells.

The investigation exemplifies the importance and focus on corporate governance in the 90's and led to three Spedley directors, including the former managing director Brian Yuill, being prosecuted and serving prison terms. One director was also banned from working as a company director for five years.

Through its investigation, ASIC identified corporate governance lessons concerning:

- the implications of there being a dominant director;
- the role of the non-executive directors;
- senior executives must be vigilant;
- effective internal controls are essential; and
- the auditor must maintain an independent outlook and fulfil all responsibilities

These two examples serve to remind us that the onus is on the directors and the board to ensure the survival of the company. Companies need to identify corporate governance principles and practices that ensure sound management of the company within the letter and spirit of the law. Every time directors ask tough disclosure or financial questions, thousands of shareholders will benefit. So we must have an atmosphere that encourages directors to be active. Directors must remember, protecting the interests of shareholders is the goal of corporate governance.

Remuneration Drivers

It would be fair to say that the majority of private financial sector employees are awarded performance based bonuses. In some cases this is in addition to their base salary, and in some cases this makes up the majority of their income, and the incomes involved are very high. Hence, there is a very strong internal pressure and incentive to perform and achieve results. I am not alone among regulators worldwide in being concerned that this focus on remuneration is sometimes producing behaviour in conflict with both the Corporations Law and the listing rules.

It arises most obviously, and was first identified, in connection with commission based financial planners. Should a financial planner have such a strong influence on where a consumers money will be placed, if it will affect the commission that they are receiving? ASIC is monitoring this area of concern closely.

ASIC is becoming increasingly aware of the practice of "churning". Churning is an illegal practice of changing clients' investments where the primary motivation is to generate commissions for the adviser concerned. This happens with brokers and institutions alike. ASIC has been informed of a number of circumstances where banks are offering investment funds that mirror those created by fund managers.

Take this scenario for example: A consumer has approached a licensed adviser regarding the selection of an appropriate fund to place their superannuation. Together, they have selected an appropriate plan that will achieve the outcome required by the consumer. The consumer enter their retail bank to have a cheque drawn up for their fund, only to be offered (and in some cases) persuaded to invest in the banks own 'mirror' fund. This is particularly disturbing and may be pose a substantial consumer protection challenge for ASIC.

Behaviour - has it really changed?

The question still arises, however, as to whether market behaviour has really changed from the 80's or whether it has just taken a different form. The two cases outlined below illustrate the point:

Nomura International plc

A referral to ASIC, by the ASX, alleged that Nomura dumped stock on the equities market in the closing minutes of trading on 29 March 1996 for the purposes of driving the All Ord's and the SPI down to a level at which Nomura could close out its open short position of 12,000 March SPI contracts more profitably. The SFE sent a referral to ASIC on the same subject matter.

Nomura appeared to be largely responsible for the All Ord's falling approx 25 points in late afternoon trading which dragged the SPI down to a closing out price of 2225. This saw Nomura close out its position at approx 2225 rather than 2250. This represented a difference of approx $8m on close out of the 12,000 contracts.

ASIC alleged that conduct engaged in by Nomura in connection with the sale of securities amounted to:

- market manipulation;

- wash trading (ie. Trading in securities in which Nomura was both the buyer and seller and there was no beneficial change in ownership);

- misleading and deceptive conduct in connection with dealings in securities; and

- conduct calculated to create a false or misleading appearance with respect to the price of the SPI futures contracts.

The Federal Court found that Nomura's strategies constituted misleading and deceptive conduct in the securities and futures markets, thereby breaching the Corporation's Law and the Trade Practices Act.

Nomura was a landmark decision that will help establish the boundaries of acceptable trading strategies not only in Australian markets, but also for players in the international securities and futures markets. The matter has now been concluded by Nomura accepting the judgement, paying all our legal and investigation costs, and entering into enforceable undertakings that will reduce the risk of any future breach.

This case serves to reinforce the importance of international traders in Australian markets being prepared to meet the highest standards in our financial markets.

Conclusion

The task of upholding the integrity of our entire financial system begins with the participants. When our system lives up to the highest standard of integrity, it inspires deeper public faith that our marketplace is sound.

I believe that ASIC has made a large impact on the integrity of the Australian financial system over the last 10 years and would like to conclude with our statutory objective that will guide us into the next decade:

"maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and

promote the confident and informed participation of investors and consumers in the financial system"