ASIC

Australian Securities & Investments Commission

Ownership rights and ASIC's regulatory agenda

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Introduction

Good morning. Thank you Dean and Ownership Matters for your invitation to speak here today. I welcome the addition of another advisory firm to the market.

ASIC's three key priorities

The Commission has three strategic priorities. All our work is focused on advancing our position in one or more of these areas.

The three priorities are:

- confident and informed investors and financial consumers
- fair and efficient financial markets, and
- efficient registration and licensing.

In my presentation today I will discuss a number of our listed company priorities in what I will broadly call 'governance':

- the responsibilities of directors and institutional investors;
- continuous disclosure; and
- control transactions and equity raisings.

Each of these areas of regulatory interest reflect and support important ownership rights:

- the right of shareholders to have their company managed in their best interests (corporate governance rules)
- shareholders' basic right to know about the affairs of their company and to invest in fair markets (disclosure requirements), and
- the right to equal, efficient, competitive and informed participation in takeover transactions and equity raisings.

I will close with a brief discussion about market structure.

Corporate governance

Directors

Directors are the focal point for governance of corporations. All decision making is devolved from them. Shareholders' main power is to determine whether directors should continue in office. It is therefore fundamental that directors oversee their companies properly, and provide relevant and accurate information to members.

ASIC has taken a number of legal actions recently that look to establish the standards we, collectively speaking, expect of our directors.

The Federal Court decision in ASIC's case against the directors and former executives of Centro Properties Group is a clear example of where ASIC believed that the directors' behaviour failed to meet the expectations of the law. I understand that the engagement of directors with auditors on the 30 June and 31 December 2011 accounts was significantly greater, and at a more sophisticated level, after the Centro decision was delivered.

While ASIC continues to consider effective enforcement action to be an important tool, it is one that we of course use sparingly. It is only one of a number of ways we seek to improve standards and behaviour. That is relevant to comments I will make later on continuous disclosure.

One of the tools we think is particularly complementary to enforcement is education. It is important to get out the timely lessons that directors and advisers can learn from Centro.

Institutional investors

Institutional investors are 'gatekeepers' in ASIC terminology. You hold our money and invest it on our behalf. The diligence with which you carry out your business is important to your direct investors, but it also impacts the whole market. You are the informed investors that we rely on to establish market prices that reflect underlying value.

Increased institutionalisation of share ownership in recent years has resulted globally in wider recognition of the importance of the monitoring role of major institutional shareholders.

ASIC's equivalent in the United Kingdom, the Financial Services Authority (FSA), requires compliance with the UK Financial Reporting Council's Stewardship Code on an 'if not, why not' basis.

The UK code has placed significant emphasis on the role of institutional investors in promoting good corporate governance by entering into a dialogue with companies about their corporate governance practices and systems. It also requires disclosure of the use made of proxy voting or other voting advisory services.

In Australia we have not gone so far. It's clear that institutions cannot delegate away their decision making on voting. We do encourage every institution to turn their mind to these issues, and disclose to their members their decisions.

These are interesting issues, and forums such as today help promote further discussion. I am pleased to participate. As a regulator of corporate conduct

ASIC obviously has a keen interest and supports industry initiatives which may improve corporate governance practices in our market.

Continuous disclosure

Compliance with continuous disclosure goes to the heart of ASIC's strategic priority of fair and efficient financial markets. Compliance with our continuous disclosure laws is essential, not only for investors but for the broader capital markets. Foreign sourced investment accounts for 40% plus of our markets, and to maintain this confidence in our market we must maintain our reputation for market integrity.

We have a number of regulatory tools available to deal with continuous disclosure. A unique one is infringement notices. They have been a timely and efficient remedy for dealing with some breaches of the continuous disclosure laws.

ASIC has issued nine infringement notices in the last three years (three last month to Leightons). In 2004, when the new regime was introduced, ASIC issued Regulatory Guide 73 *Continuous disclosure obligations: Infringement notices* (RG 73) that stated we would generally aim to issue notices within three months of identifying the breach. Clearly that has not proved possible. We do not want to issue notices precipitously, before we are sure of the facts and the conclusion that there has been an actionable breach. We will be amending the guide to remove that aspiration.

Nevertheless, the infringement notice system is considerably quicker than the alternative of court proceeding. The Fortescue case is exceptional, in terms of appeals, but the events in issue there occurred in 2004. We certainly propose to continue to use this tool but, as I said earlier, we do use enforcement tools sparingly. Education is important.

There are a number of messages which come out of our continued regulatory focus on market disclosure.

Firstly, all listed companies need to consider what is best practice to ensure they have adequate procedures in place to comply with their continuous disclosure requirements. That helps if we need to discuss enforcement action.

Secondly, listed entities must be prepared to disclose the downside as well as the upside, in an equally timely manner. Company directors quite rightly expect full disclosure from management of both good and bad news in order to make informed decisions – and shareholders have similar expectations.

The meaning in the ASX Listing Rules of the word 'immediate' is the subject of much discussion in the market and the media. It is not possible to

set down hard and fast rules about what that means, given the diversity of events that may give rise to a disclosure obligation.

It is not 'at the instant', but it is also not 'when practicable'. The Concise Oxford Dictionary says immediate means at once and without delay. That does not shed great light on the issue.

ASIC recognises that companies need to gather sufficient information to make an announcement that is accurate and not materially misleading. This does not mean that every fact and every possibility must be explored to the nth degree. In my experience, the existence of certain facts is not in issue, but the implications of them for a company may require more work. In that event, companies can announce just that, and update when the implications are more clear.

The significance of the requirement to make immediate disclosure is most apparent when there has been a loss of confidentiality. Our consistent message is that entities should be quick to ensure that the whole market knows about a deal once it seems that some of the trading market knows. If a prospective deal is being reported on the various news wires, the company needs to tell the market the accurate position.

The entity must announce the position or go into a trading halt if that is not possible – say, because the deal is not finally signed. A temporary halt is preferable to allowing trading to continue where some of those placing orders on the market may have an unfair information advantage over others, which they are prepared to exploit.

Companies should not 'time' their announcements – that is, reach agreement but agree to resolve a technicality at a later and more convenient time. There is a high risk of loss of confidentiality and ASIC will have little sympathy for that type of conduct where some investors have been damaged in the market.

We continue to work with chartered secretaries and the Investor Relations Association to promote best corporate practices for information retention.

ASIC does not believe the James Hardie decision is authority for a requirement that the board must approve every announcement. Some decisions of strategic direction do require board approval; others are capable of delegation. I expect most of the 'event' announcements are in the latter category. That is not to say that boards should not have oversight of the disclosure decisions, to ensure the review process is robust. That is also important.

I do want to emphasise ASIC's view is that there is, broadly speaking, good compliance with the continuous disclosure regime in Australia. We take very few actions relative to the number of announcements made, and for far fewer

than the market commentators say 'must' be breaches. This approach also reflects our understanding that disclosure issues can sometimes be very difficult, and judgment calls are required. We do canvas the questions of available information, accuracy, compliance systems and opportunity when deciding to pursue cases.

Takeovers

Our strategic priorities of confident and informed investors and financial consumers, and fair and efficient financial markets are also at the forefront of our regulatory work in the takeovers space.

The principles underlying the regulation of takeovers, which we also apply to other control transactions such as schemes of arrangement, include the maintenance of an efficient, competitive and informed market, and equality of opportunity to participate in the benefits of the transaction.

I would like to mention a number of issues we have recently been considering in the context of takeovers:

- the use of equity derivatives
- collateral benefits, and
- equality and fairness in rights issues and capital raisings.

Equity derivatives

A topic for discussion at the moment is the use of equity derivatives relating to a substantial holding in an entity.

The *Corporations Act 2001* (Corporations Act) requires timely disclosure to the market of substantial holdings in quoted securities (more than 5%). Full disclosure of the interests of substantial holders is important information the market is entitled to.

Whether a person entering into an equity derivative is required to disclose under the Corporations Act will depend on the nature of the derivative, the agreements that surround the entry into the derivative, and the understanding reached about hedging.

We are concerned by the use of cash-settled equity swaps where the arrangements include voting rights in a listed entity. We hear the market is now asking for voting rights with cash swaps. We are keen to remind users of derivatives of this kind that if there is any agreement or even understanding affecting voting, then that gives rise to a disclosable interest. We are monitoring for this takeover transactions.

Unequal treatment (collateral benefits and rights issues)

When we review control transactions we always keep a close eye out for any additional benefit to a person that may be involved.

Unequal treatment of members in a control transaction may be contrary to both the prohibition on collateral benefits and the Eggleston principles. We closely examine the commercial drivers of the transaction – particularly with related parties.

Where we have concerns that shareholders may be treated unequally we will often seek changes to the structure of the transaction or the approvals required, before the deal is public. Where we cannot come to agreement we may apply to the Takeovers Panel, or to the court in the case of schemes of arrangement.

A common area we look at is rights issues. It is possible in some cases for a major holder or an underwriter to increase or acquire control of a company through a dilutive rights issue. The potential for this to occur is heightened where there is likely to be a significant shortfall.

ASIC and the Takeovers Panel expect that boards will properly consider the effect of any rights issue on existing shareholders. A rights issue may be the subject of an application to the panel where a board has not properly considered appropriate dispersion strategies to mitigate any potential control effect.

Placements

It is timely here to make some comment on capital raisings generally. ASIC has been monitoring the capital raisings in our market since 2008, cognisant of some commentary that they unfairly prejudice the existing members.

ASIC believes the directors of a company are best placed to determine what means of capital raising is in the best interests of the company as a whole. As we said in 2009, we will, however, seek law reform if there appears to be widespread unfair dilutions.

In 2009, we took steps to facilitate retail access to placements at the same discount offered to institutions through wider relief for share purchase plans. At that time, retail did not seek to participate in those offerings. The market is less alarmed now, and retail has a greater appetite for participation.

The renounceable rights issue is a long-standing instrument for giving retail access at the institutional discount, and for giving those who choose not to participate at least some of the upside benefit. We encourage this model. The share purchase plan is a proxy for the rights issue participation, but of course will not compensate for dilution, so is less favoured.

It is my personal belief that directors need to tell the market more about why they decide that a particular capital raising is appropriate. There is some significant distrust in the market about the process, as is evident by the market commentary.

What would be good disclosure at the time of a raising (in my personal view, I hasten to say – the Commission has not considered this formally)?

- Why did the directors elect a particular form of raising?
- If directors choose not to go the renounceable rights route, then why not?
- How was the issue price selected?
- What and with whom are the underwriting and sub underwriting arrangements, for fees and other benefits?
- Any related party arrangements?
- What is the allocation policy, and will the company give priority to applications from existing investors?

Market structure

Today ASIC is releasing its latest thinking on market structure reforms.[1] We have been consulting largely with the exchanges, the major investment banks that provide a crossings service, and brokers, about how we should regulate the securities markets.

In November 2011, Chi-X offered a trading exchange in competition with ASX, for the ASX 200 securities. Its market share is increasing. The rules we put out for the competitive environment were the minimum necessary. We released Consultation Paper 168 *Australian equity market structure: Further proposals* (CP 168) earlier in 2011, outlining our thoughts on further reform, to phase in from late 2013. Today's paper updates that.

The paper covered a variety of market concerns, and reflected commentary on the overseas markets with which we compete for capital, and those markets whose evolution we are tracking – here I specifically refer to Canada, the United States and Europe. The broad topics covered were:

- automated, including algorithmic, trading
- volatility controls for extreme price movements
- product scope for best execution
- enhanced data to ASIC for market surveillance, and
- pre-trade transparency and price formation.

[1] Media Release (12-61MR) *ASIC provides direction on market structure reforms* (3 April 2012).

One topic is pre-trade transparency or 'dark pools'. Traditionally, institutional investors used the crossings market to handle large orders. The very fact of a large order would affect the prices on offer. The large investment banks' crossing facilities have expanded their reach considerably. We estimate that the value of trading on dark pools in Australia grew from just 2.5% to 4% of market share in the last six months of last year.

ASIC is proposing a range of alternatives to encourage participants to trade first on the lit (and licensed) exchanges. These proposals are the subject of much debate and I encourage you all, as institutions and corporations whose securities are traded on exchanges, to get involved.

The focus of the debate is the point at which there is so much trading on the dark market for price discovery to be damaged, to the detriment of the overall market. I think there is agreement that this point can be reached, but the question is what it is. In the United States, there is significant concern that it has been passed, and debate is now about how to constrain dark pools. The US market is far deeper than ours.

Our research indicates that spreads do widen as the markets fragment, which is a leading indicator of sub-optimal price discovery. We are concerned that the retail investors, stuck in the lit market, lose out altogether due to preferencing in the pools.

In Australia there is very little regulation and integrity supervision of dark pools. That is not the international practice. Is that optimal?

The only other point I wish to raise here, as it is relevant to how you as institutions deal, is our proposed rules on the use of automated trading and algorithms. These trades now dominate the market. That is not per se a problem, though it certainly complicates our job of market surveillance. We are very alert to the programs that can lead to a systemic problem, due to inappropriate systems that reinforce price cycles. In other words, generate a 'flash crash'. We are concerned about abusive or manipulative programs. We require testing by your brokers. That is a cost to you, but it's essential for an orderly market.

These are complex issues, but they are very important. I do ask you to get involved in the discussion. The markets themselves are engaged and you need to have a view. We at ASIC do recognise that we need to do more work with all of the industry on the topic.

Conclusion

ASIC's priority is fair and efficient markets.

Happy to take questions.