



**ASIC**

Australian Securities & Investments Commission

# Capital markets update

**Speech by**

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**to the**

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**[Check against delivery]**

## Introduction

Good morning, ladies and gentlemen.

Thank you for the invitation to open your conference today.

The corporate investor relations executive has assumed critical importance for the corporate community in the current environment. It is timely that you gather here together to discuss the issues you face.

This conference was arranged much earlier this year. Who would have expected that this morning's agenda would take the shape it has? Following me, you will have presentations on the volatile markets, the outlook for the economy in the next 12 months, and a panel session on short selling.

My own topic was set 6 months ago: 'An update on the Capital Markets Taskforce review of insider trading'. That topic is still important, but I have taken the liberty of morphing it into a more general discussion applying the Taskforce's work to present circumstances.

We are all dealing with the issues emerging from the 'GFC' (an alarmingly well-known acronym for the global financial crisis). I am sure each of you must face 2 types of issues every day: when should your company disclose new information to the market (particularly revisions to forecasts and accounts), and just how should you deal with the 'rumours' that seem to flow around the market?

These are challenges that unite us all. We need to adapt our ways to respond effectively to these challenges.

Today I want to address 3 areas central to the behaviour of listed entities in this changed environment:

1. First, I will talk about the need for good disclosure in a volatile market, and will give you my thoughts on responding to rumours.
2. Second, I will give you an update on the work of ASIC's Capital Markets Taskforce. We have some achievements to be very pleased with. The Taskforce focus moved to 'Project Mint' from March this year and it is timely to expand on that project. That will naturally lead (again) to the problem of rumourtrage, and what we at ASIC are doing.
3. Third, I will touch on the analyst and investor briefing review that we announced in August this year, as many of you will have engaged with us on that. That, of course, is now the subject of a referral by the Minister for Corporations Law, Senator Nick Sherry, to the Corporations and Markets Advisory Committee (CAMAC).

## 1. Disclosure in a stressed economy

I wish to start with recent developments in the Australian markets, and our economy. Your directors will need to turn their minds to the implications of this turmoil—for the company, and in turn, for the market in terms of its disclosures.

I want to mention 2 areas where we see the need for your focus:

- *The first area of disclosure is statements to the market about earnings guidance and prospective balance sheet adjustments.* I think the market recognises that there are changed economic conditions and that achievement of earlier forecasts will be difficult. Indeed, re-achievement of last year's results will be challenging for many. It is inevitable that there will need to be some revaluation of balance sheet assets.

The first question to arise is: when do directors have sufficient hard information to update the market, against their earlier outlook statements, and possibly against market consensus estimates? The Australian Securities Exchange's ASX Guidance Note 8 refers to a need to disclose material variations in previously released forecasts or expectations, and says 'as a general rule a variation in excess of 10% to 15% may be considered material'. I would urge you to be conservative in this regard. The overriding test is in Listing Rule 3.1: to disclose information that might be expected to have a material effect on the price or value of an entity's securities. In this volatile market, I believe that variations at the lower end of the scale might reasonably be expected to impact price materially and should be disclosed.

The second question will be: just how sure can directors be that these numbers are sufficiently certain to be pronounced to the market? We are already seeing early foreshadowing of changed positions for the half-year results coming through, and I expect that will increase in the coming weeks.

Of course, giving earnings guidance will need careful consideration. The issue of civil liability of the company (and of directors) for false or misleading statements is not to be disregarded. There will need to be a lot more disclosure to the market about the assumptions that underlie particular forward-looking statements, and the risks of those assumptions not being achieved. This greater explanation will be necessary both to adequately inform the market and to qualify statements in a manner that comforts your lawyers.

I do not pretend to suggest that the issues are easy to address. I think they will need more discussion in the coming months. I know your Association has a working party looking at commentary on consensus

estimates, and I encourage you to give your feedback. It's important to the market, and I suspect there is room to work with the information vendors to improve the quality of information available to all the market.

- *The second area of disclosure I want to raise is the content of accounts.* The half-year results to December will need to reflect the market downturn, both as it affects the revenue statement and balance sheet. ASIC will shortly release its semi-annual commentary on the annual accounts just lodged, and our focus for the next 6 months. It's a tough read for the non-accountants among us. It won't surprise you that the headings are 'Going concern', 'Impairment of assets' and 'Determining fair values'. There is quite a lot about the desirability of more disclosure of assumptions, and testing of risk areas. That ties neatly back to my earlier comment that more statements to the market about the assumptions underlying statements is good.

### ***Responding to rumours***

I want now to turn to how companies respond to rumours—a matter you must all be preoccupied with.

There is a lot of commentary about the way a share trader's psychology changes in a falling market. Trading is for the short term. The response to news is not necessarily value-based or rational. The trader's response is more connected to what he or she thinks other traders will do. A challenge for us, and I am sure for you, is to work out whether a particular announcement is likely to result in a price increase or decrease.

I've read some interesting discussion (in *New Scientist* of all places) about how traders need to change their models to accommodate this more 'human' reaction—for which you should read 'unpredictable'.

As many of you know, this means that unsubstantiated rumours can have a big market impact, however ridiculous they may appear on their face, or however immaterial they may seem to be to the business of the company.

One of your roles is to know what the market understands about your companies. You need to know what analysts are saying. Somehow you need to know what the broking house sales desks are saying, which is commonly different from the analysts' recommendations, and at times diametrically the opposite. You need to hear the rumours early—no easy task.

Many of the rumours I see appear to have some factual credibility. The objectionable element is often the conclusions drawn from a relatively minor fact, and the manner in which they are pitched into the market.

I understand companies do not want to be drawn into a situation where they are practically obliged to respond to every rumour, particularly as the substance nears the truth and a simple 'no' is not sufficient. It is, however, clear that just ignoring rumours will not work in this market. There will be some stories that have achieved such widespread fame, or infamy, that they must be confronted: the company must advise the ASX of the rumour and the true position to prevent there being a false market. Other stories will be close to the mark, and these will need to be affirmed to the market. The litmus test for you is the false market.

I think the market is most comfortable where it believes the company has already told the full story. This means that the company must have a sound reputation for good disclosure: timely and accurate, and not misleading. Your Association works hard to promote good practices, and I encourage you in those endeavours.

One thing is very clear: when dealing with rumours, the company and its advisers must not engage in selective disclosure of material information. It is not enough for you to call your major institutional desks, or the journalists, to set the story right, and rely on them to spread the word. That is just war by 'counter-rumour'. If the information is price-sensitive, then everyone must be told it, through the ASX platform.

### ***Information retention***

Listed entities also need to pay greater attention to confidential information retention.

As I said, rumours often start with some factual statement, and these are often fairly true. ASIC cannot prosecute for making false or misleading statements if the story is true, even if it is secret, or passed on without concern for the truth.

I urge your companies to be very disciplined in establishing information barriers around price-sensitive information. I urge you to rigorously apply the 'disclose only to those who need to know' rule. Stop the flow of information that seeds a rumour. ASIC intends to take this proposition up with the market in the new year.

News spreads very fast in this climate and it affects market prices quickly. Companies that are aware of impending news and are juggling when to disclose it must be very alert to a leak and must advise the market immediately. I emphasise the word 'immediately'. The Listing Rules permit non-disclosure only where information is still confidential.

## **2. ASIC's Capital Markets Taskforce: improving enforcement of market abuse offences**

We established our Capital Markets Taskforce a year ago this month. Its mandate was to review ASIC's record in the enforcement of market abuse offences and to design a strategy to improve our performance. The market turmoil that started earlier this year has brought the issue of market integrity into sharp focus.

The Taskforce analysed ASIC's enforcement processes, and also looked at the approaches adopted by overseas regulators, particularly the US Securities Exchange Commission (SEC), the Financial Services Authority (FSA) in the UK and the Hong Kong securities authority. We consulted with the 2 bodies we work with in the market enforcement space: the ASX and the Commonwealth Director of Public Prosecutions (CDPP). As you know, ASX is the frontline supervisor that has the technology for computerised oversight of trading. The CDPP is the Commonwealth's independent prosecutorial agency.

The result of the Taskforce's research has been built into ASIC's strategic review, which was implemented on 1 September 2008. We now have 2 specialised market deterrence (read 'enforcement') teams. The MarketWatch group, which takes the initial referrals of suspicious market transactions, is now part of the Sydney deterrence team. We have strategies to reduce duplication of work as it passes from ASX through ASIC.

We have committed to increase training and development, and to focus the knowledge among specialist lawyers, analysts and investigators. Markets cases are hard—the world over, the 'hit rate' for turning a referral of suspicious conduct into a prosecution is one of the lowest for securities offences. We are building experience and expertise in ASIC. We have acquired technology to streamline our inquiry and investigation process.

We are already more efficient and effective, and I believe there is yet room to improve. What is the evidence to support my conclusion that we have made advances? This calendar year:

- Charges have been laid against 5 people (3 announced just last week), for insider trading, misuse of company information to buy new shares, market manipulation and short selling. More are expected shortly.
- 11 more market cases, involving 19 possible defendants, are with the CDPP for consideration. These relate to trading between 2005 and 2007 and cover insider trading and market manipulation. 7 more cases are expected to be referred to the CDPP by the end of February next year, all relating to activities in 2008. This includes one summary prosecution for late filing of directors' trading notices with the ASX. Of the other referrals

and prospective referrals to the CDPP, 10 cases concern insider trading, 7 concern market manipulation, and 1 concerns illegal naked short selling.

- This year has seen 4 bannings from the financial industry for market manipulation and 6 cases for banning are presently under consideration by ASIC delegates.
- Some 58 cases are being managed by the deterrence investigations teams (including those with the CDPP)—26 for insider trading, 19 for market manipulation and 13 for continuous disclosure.

At the start of the year, there were just 6 cases in trial and 3 cases with the CDPP for consideration, all fairly old. Some were heard, and not successful. We withdrew from some when it became clear we may well not succeed. So I would say we have come quite a long way from a standing start.

### ***Project Mint***

One of our responses to the market turmoil was our announcement on 7 March 2008 that we had launched an inquiry into whether the markets were affected by short selling on the back of false rumours or collusive behaviour. This was the start of Project Mint.

In the first 3 months of the inquiry, we served over 70 notices on all the major brokers, requiring delivery of share trading records and broker communications. Many more have gone out since then, to the major brokers and more recently to the retail brokers.

We've worked through an extraordinary number of emails, instant message logs and voice recordings. I have said on other occasions, and confirm today, that the brokers have been by and large most co-operative, promptly delivering information in a way that facilitates our analysis. It has also meant that we've started a dialogue with the major brokers, stock lenders and hedge funds about good market behaviour. This has laid a strong foundation for the future.

We will want more active assistance from brokers in our market surveillance, investigation and prosecution activities in the coming months, and you will be seeing ASIC taking a stronger line in advocating improved practices among all financial industry participants. The recent announcements on short selling, and our dialogue with the market on the implementation of the new rules, has added to our communication channels with the industry.

The Capital Markets Taskforce has now folded its cards, since the restructure commenced. Project Mint is ongoing and now has 3 separate streams:

- *The first stream of Project Mint is ongoing inquiries about current events, looking at reasons for trading and for the presence of rumours.* We said in September this year that we were looking hard at this again, as the

rumours reached intolerable levels—one of the reasons we felt we had to ban short selling.

Can I say here—one of the harder tasks for ASIC is locating rumours. I mean by this not just the story but who is telling it. There is an element of ‘dob’ in this, but we can’t stop that which we can’t find. We do experience some reluctance to tell us more than ‘someone is saying’. Any success that a regulator has had in trailing a rumour starts with a good and very quick tip: what, who and where. You can contact us at any time with a good lead.

- *The second stream of Project Mint is formal deterrence team investigations into a handful of matters, with a view to prosecution through the CDPP, or seeking for persons to be banned from the financial industry.*

I said earlier that 4 people have been banned this year (2 are appealing). It is a new strategy for ASIC in the market integrity space—to move quickly on seeking a banning from the industry in conjunction with our civil/criminal inquiries into offences, which of course can take a long time to come to trial, if at all. This strategy has come from a suggestion made at our Summer School in February this year—that banning is an effective tool in the financial industry, and will be a strong deterrent, in part because it is quicker.

What offences are we looking for in connection with rumours? The first is for breaches of the rules prohibiting false or misleading statements (s1041E and 1041F of the Corporations Act). Another is the prohibition against persons engaging in dishonest conduct in the course of carrying on a financial services business (s1041G). The third is insider trading. Under our laws we only need to show that a person is in possession of price-sensitive information. We do not need to establish that the person is an insider. A person passing on the ‘hot tip’ might well be purveying inside information illegally. Minister Sherry has referred to CAMAC the regulatory framework for managing the spreading of false or misleading rumours, and we expect to contribute to that discussion in the fullness of time.

- *The third stream of Project Mint is more long-term. As I said earlier, we have learned a lot about how the market actually operates. We have inquired about house practices on dealing with research and in promulgating rumours. In the new year, we will talk to specific broking houses about our findings of colourable conduct, by which I mean ‘selling’ conduct that probably falls short of illegality but which we want to discourage.*

It is premature for me to foreshadow our policy work on broker conduct in spreading rumours. Brokers may not create all rumours but they are central to spreading them. There does come a point where a broker must discuss a



rumour with clients, because the rumour is fuelling the market. We will be consulting with the financial industry and with our international colleagues on best practice. One of the developments in recent months has been the global response to the GFC—all major regulators are talking regularly, and coordinating our responses, and in due course, some rules. Market players are international operators and we need to respond in kind.

To that end, I do wish to refer to you the FSA's very recent paper on rumours. It is most informative about their current thinking (see [www.fsa.gov.uk/pubs/newsletters/mw\\_newsletter30.pdf](http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter30.pdf)).

It outlines the FSA's view of industry best practice, to be formulated into broking house policies. A few points to mention:

- What is a rumour? That's really wide—unsubstantiated speculation.
- There must be an absolute prohibition on originating rumours.
- There must be a prohibition on passing on rumours designed to win business from a competitor (e.g. another bank).
- There is a recognition that where a rumour has become widely discussed in the market then the broker must pass it on, but there should be controls on who can pass on the rumour, and what explanation is required. High-level officers must authorise passing on rumours. The information must be clearly stated as rumour, and must be stated to be unverified. No additional credence or embellishment should be given. It should not be sensationalised.
- Firms must have effective training policies and surveillance practices.

### **3. Analyst briefings: ensuring all investors have access to information**

Turning now to something close to your hearts (or at least your profession), I want to talk briefly about analyst briefings. I said in August this year that ASIC would review listed entity investor briefings that accompany the annual results announcements. We would be looking to see the briefing information is available to all investors, and that the content accords with law—namely, it is not false nor misleading. Briefing information can often be more informative to investors than historical financial accounts, as they contain forward-looking information and commentary on the business.

In August and September this year, ASIC staff attended 29 analyst and media briefings delivered by a range of ASX 200 entities, in all cases by arrangement with the company. Our presence was announced to the meeting, which perhaps qualifies the conclusions we may draw about behaviour. Nonetheless I will say the public briefings we attended did not give rise to significant issues. We were particularly interested in entities that had experienced volatile market prices and

we selected a cross-section from a broad range of industry sectors. I want publicly to thank Ian Matheson of your Association. He was quick to contact us for more information, and then generous in assisting us with getting access, once it was clear we had no sinister intent. We at ASIC appreciate your industry's co-operation.

As you know, Minister Sherry announced last week that he was referring 4 issues to CAMAC for its examination. One was the issue of disclosure of price-sensitive information at closed company briefings.

The Minister said, 'there are concerns that confidential briefings are being provided to analysts which create the perception, if not also the reality in some cases, that some analysts may have access to critical information that is not available to other analysts, to shareholders and to the general public'. 'These perceptions,' he said, 'can lead to a lack of confidence in the integrity of our financial markets and potentially create opportunities for insider trading'.

He is asking CAMAC to 'examine the role that analysts briefings play in Australia's financial market, including whether, in their current form, their role is actually a positive one that leads to greater market efficiency, and advise [him] if any changes may be required to Australia's regulatory framework'.

I am sure CAMAC will look at market practices, and the various arrangements for holding investor/media briefings. These are commonly webcast, and the notes are despatched straight to the ASX. The recent AIRA 2008 survey indicates there is good acceptance of these practices—but there is room to improve on webcasting. It will be timely for CAMAC to look particularly at the more private analysts briefings—which I gather are a boardroom presentation format to selected research specialists and house brokers.

ASIC's '*Heard it on the grapevine*' guidance is now somewhat old—it exhorts giving consideration to a website for announcements. We will update that guidance with the benefit of CAMAC's deliberations. In the meantime, the principles in that guidance are still good (see ASIC Consultation Paper 5 '*Heard it on the grapevine*' (CP 5) at [www.asic.gov.au/cp](http://www.asic.gov.au/cp)).

## **Conclusion**

Ladies and gentlemen, I shall conclude the formal part of this presentation now. Much has been said of ASIC's recent restructure—our changes to make the organisation more market facing. We look to the market to inform our actions—we want to understand the impact of our actions on the market. We want to hear from participants such as yourselves about what is happening, and what you think we should be doing in your space. We also want to take opportunities such as this to communicate to you what we think you should be doing in the public space.