



ASIC

Australian Securities & Investments Commission

Improving confidence and integrity in Australia's capital markets

**A presentation by ASIC Commissioner,
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Economic Development of Australia
(CEDA), Sydney**

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Introduction

Thank you for the opportunity to speak to you about improving confidence in the integrity of Australia's capital markets and about ASIC's Capital Markets Taskforce. I will also speak about the ASIC Strategic Review, as the work done by the Task Force has informed some of the changes that the Review proposes.

The Taskforce was established in November 2007 when I joined ASIC. Its mandate was to review ASIC's record in the enforcement of the markets abuse offences, and to design a strategy to improve our performance in that area.

In this presentation today I would like first to review briefly what market integrity is and why it matters, and what ASIC can do to improve market confidence. I will then outline some of the achievements of the Taskforce in the last 6 months. I will then turn to the ASIC Strategic Review and provide a broad outline of the main projects that the Taskforce has identified for the next 12 months for improvement of market integrity.

Market integrity

If I may take a few moments of background. Market integrity is a term to cover the two key features of fairness and transparency in a financial market.

By transparency I mean the ability of all investors to have equal access to price sensitive information about traded entities. The laws requiring the continuous disclosure of information to the market are designed to maximise market transparency. Continuous disclosure obligations of course supplement the comprehensive listed entity disclosure regime in the Corporations Act and Listing Rules, that starts with the IPO prospectus, requires yearly and half-yearly reports and accounts, and prescribes takeover document content.

Transparency also requires information about prices and available volumes of traded securities. The market rules of the licensed exchanges must ensure this information is available.

The other limb of market integrity is fairness. It is unfair for some traders to take profit because they have greater information or greater power to manipulate the market. These traders are the focus of laws against insider trading, market manipulation and spreading false information.

The Commission recently announced the outcomes of our major strategic review, which will see the transition to a new structure completed by 1

September. I will elaborate on the significant outcomes later in my presentation. But as part of the review we commissioned a stakeholder survey. There are a few interesting points I want to share with you:

- 69% of respondents felt Australia's capital markets compare well with other countries. Only 5% disagreed.
- but only 15% felt that the markets are free from insider trading and other market abuses.
- 72% of respondents wanted ASIC to focus more on prosecuting offenders – higher than any other priority.

You would have seen in the press reports of some figures presented at the ASIC Summer School in February. These show significant early price movements in the 40 days before takeovers are announced, and early falls before bad results are made public. It is difficult to know if this is clever speculation, tracking funds that follow a similar movement, momentum traders, just market noise, or something more sinister, like insider trading. It is our task to divine and prove this to the courts' satisfaction.

Why does "market integrity" matter?

There are two answers to this question. The first is economic. There are a number of studies which conclude that markets which exhibit relatively high trends of integrity have greater liquidity. Markets with a successful record of enforcement of insider trading laws and disclosure rules have a lower cost of capital. These studies lead to the conclusion that market integrity is an important feature in ensuring our markets are internationally competitive for capital.

The second reason why market integrity matters is more human. It is psychological. People will be more willing to deal in a market where they have an equal opportunity to take profits, and others cannot take unfair advantage of company information or of power.

ASIC's steps to improve market confidence

There are a number of steps ASIC can take to improve confidence in the integrity of Australia's markets.

The enforcement proposition

One is to win some cases. The Taskforce has identified some measures which should improve our effectiveness in surveillance, investigation and prosecution of markets offences. We are working closely with the ASX and the Commonwealth Director of Public Prosecutions in a number of

ways. All of us have a role to play in identification and, where justified, the prosecution of offences.

All ASX referrals of suspicious market transactions go to our MarketWatch team for preliminary assessment, along with ASIC-generated referrals. At present our MarketWatch team is looking at 25 referrals of suspicious transactions:

- 11 insider trading questions;
- 4 market manipulation questions; and
- 10 continuous disclosure questions.

In addition our National Assessment & Action team (the public complaints team) has over 145 reviews of market abuse complaints underway, mostly in the small cap market.

If MarketWatch or NA&A decides there is substance to the referral then it is passed to the enforcement team. They must prove a case up to the point that legal proceedings can be brought. In our technical parlance, they commence an investigation. There are currently 61 active investigations:

- 29 for insider trading;
- 16 for market manipulation; and
- 16 for continuous disclosure or false disclosure.

For completeness, there are 6 markets cases before the courts, excluding cases under appeal. There are three criminal prosecutions and there are 3 civil claims. There are 10 cases (involving 15 individuals) with the Commonwealth Director of Public Prosecutions for independent consideration for prosecution. There are also a number of applications for banning as a financial adviser underway.

ASIC's dialogue with the market

A second step that ASIC will take to improve confidence in market integrity is to be a more public regulator, leading discussion in the markets about the rules and our enforcement policies. This includes letting the markets know what we believe the law requires of participants.

Earlier this year ASIC, together with the ASX, issued a number of information releases which were intended to remind market participants of their obligations. The falling market conditions were (then) a relatively novel event and it was timely in March to remind the market of the importance of disclosing the "bad news" events promptly.

This meant adverse loan facility events and significant margin loan exposures. It was also appropriate to tell the market we are looking hard at manipulative behaviour that is illegal. I will return to ASIC's Project Mint later. It has resulted in a major step forward in ASIC surveillance capability.

Last Wednesday I discussed disclosure at a joint ASX and ASIC Listed Companies Event in Brisbane and gave some indication to the market of ASIC's expectations on continuous disclosure. In brief:

- 30 June is the financial year-end of most Australian companies. Financial performance for the year will be crystallised as accounts are finalised and audited. Our Chief Accountant, Lee White, highlighted the areas we will be focusing on in this reporting cycle – including impairment of asset values, determining fair market values, and the use of off balance sheet arrangements.
- Companies must be mindful of disclosing major changes in financial position to the market promptly. I have been surprised that some entities do not release their results immediately when they are determined. Their directors must be taking a very bold view that the content of a results announcements is not disclosable material price sensitive information.
- Some companies look to manage the timing of the release of results by delaying the finalisation of accounts. Everything is agreed between the directors and the auditors except a line that needs to be checked. No one is in any real doubt about the content of the line, and it is unlikely to be material. Presumably the directors will say that these accounts are incomplete or generated just for management purposes, so are within the continuous disclosure exemption in the Listing Rules. Directors should consider if this practice is prudent. If the "almost final" accounts contain finalised items which of themselves are material price sensitive information then disclosure of those items before finalisation of the accounts is required.
- There is one other "announcement timing" issue to address. This relates to signing and announcement of material agreements. Take a situation where a listed company reaches substantive agreement on a deal, then delays formal signing until it is ready to announce to the market. Perhaps a minor provision is left open, so the incomplete proposal exemption from disclosure in the Listing Rules is available. Perhaps agreements are finalised and placed in formal escrow, to be released automatically when a technical condition is met. The point at which such an agreement ceases to be an incomplete proposal is a matter for debate on a

case by case basis. The second limb of the Listing Rule disclosure exemption requirements is that the agreement remains confidential. ASIC expects companies that are managing the timing of disclosure is in this way to be especially vigilant for any loss of confidentiality, and to immediately announce the agreement if confidentiality appears to be lost.

The achievements of the last 6 months

The market turmoil of the last 6 months has at least drawn attention to the issue of market integrity. A number of companies suffered severely. No doubt the price falls reflected an adverse assessment of their complex business models and high leverage. There was considerable speculation that predatory short selling activity in those stocks magnified the value adjustment.

This takes me to Project Mint (market integrity). On March 7 we announced that we were investigating whether the markets were affected by short selling on the back of false rumours, or collusive behaviour, both of which are of course illegal.

That is a continuing investigation. It is likely to take some months yet before we can form a view on whether there has been illegality. I can say that there is evidence of some suspicious trading activity, though more limited than was rumoured to be the case at the time.

The project has already delivered some excellent results, in terms of the advancement of ASIC's skills to enforce the market rules.

- We served some 71 notices on all the major brokers, requiring delivery of share trading records and broker communications. We are currently working through some 580,000 emails and 220 hours of broker voice recordings. This is a mammoth task. The brokers have in most part been most co-operative, promptly delivering information in an electronic form that facilitates our analysis. This will be a model for future surveillance work with those brokers.
- We have utilised the latest technology to quickly establish trading profiles, effectively to recreate the course of trading, and to link it back to specific broker activity.
- Importantly, we have started a dialogue with the major brokers, stock lenders and hedge funds about good market behaviour. This work will be a foundation for the new ASIC stakeholder teams once the strategic review is implemented. It will be an important part of our deterrence program.

I will mention in passing the other activities of the Taskforce. Each year ASIC must assess the current markets licensees. We recommend to the Minister whether new licences should be granted. We grant exemptions from licence requirements.

You would I am sure be aware we have provided a report to the Minister on competition for market services. We have just issued a consultation paper with the Treasury on mutual recognition of markets. We also joined with Treasury and ASX to conduct a market consultation on the regulation of short selling and stock lending. These issues are presently with Treasury.

ASIC's Strategic Review

In May ASIC announced a strategic review, and restructure. ASIC will replace its four current market facing directorates with 12 outwardly focussed stakeholder teams covering the financial economy, and 6 specialised enforcement/deterrence teams. Some 7 of these groups will have a primary capital markets focus: corporations, small caps, exchange market operators, investment banks, market participants & stockbrokers and accountants & auditors, and of course the market integrity deterrence team.

As a result our stakeholders will see an ASIC that better understands the market it regulates and one that is more forward-looking in examining issues and assessing systemic risks. Stakeholders can expect the regulator to better articulate why it has chosen to intervene and the behavioural changes it wants the market to make. They will also see that ASIC has a clearer set of priorities. A major priority will be maintaining and improving confidence in Australia's market integrity. We will be preoccupied with preventing (deterring) insider trading and market manipulation practices and with the improvement of disclosure practices.

The next 12 months

This brings me to a discussion of the work of the Capital Markets team in the next 12 months.

We have formalised some key objectives for better market regulation, most of which I have already touched on:

- To be a public regulator, leading discussion in the market about the rules.
- To enhance the visibility of ASIC in the regulatory space by undertaking its own surveillance.

- To improve the reputation of ASIC as an effective enforcement agency that is respected by market participants by bringing and winning cases.

To achieve this the Taskforce made a number of recommendations which respond to the three principal themes of a good deterrence proposition: the best is prevention of illegal conduct, but if it does occur – then it must be detected quickly, and wrong doers must have a real fear that they will be caught and face meaningful sanction.

- *Prevention:* we commenced a dialogue with the business community about the importance of market integrity at the ASIC Summer School in February and our regional Listed Company Events with ASX in March and July. These will continue in each state. The discussions with brokers and investors mentioned earlier as part of Project Mint was another step in developing working relationships with all market participants. They have the frontline responsibility to manage information flows and educate staff about illegal trading activity. More contentious is their reporting of suspicious conduct. We want more active assistance from them in our investigation and prosecution activities. In the next 12 months we will be stepping up our presence in the public domain, advocating significantly improved practices amongst all the financial industry participants, including advisers.
- *Detection:* We work closely with the ASX on the detection and investigation of suspicious trading. We have both taken steps to improve our communications, with each other, with brokers and with possible wrongdoers. Already the standard referral assessment phase has shortened. The Taskforce has identified more opportunities to improve our work – focussing on new information technology products, different review lines, and the adoption of new investigation techniques, learned from our US and UK colleagues.
- *Enforcement:* The UK Financial Services Authority has adopted the term 'credible deterrence'. This means, in short, bringing successful prosecutions. Most of the Taskforce recommendations go to the design of a structure that should enhance our focus on markets offences and our enforcement skills. We will move to a single markets review team to deal with each referral, from detection of the initial suspicious conduct all the way to finalisation. Our senior team will all be experienced markets offences specialists. We will develop dedicated training programs for all our staff. We have sent cases against 12 people (6 new matters) to the Commonwealth DPP for

consideration for prosecution since 1 January, 8 proposing insider trading prosecutions. We are working closely with the CDPP on these projects. This year we have already issued 3 continuous disclosure infringement notices. In the previous four years we had only issued a total of 8. So we have already seen a significant step up in enforcement activity.

The intent of ASIC's major strategic review is to bring ASIC closer to the market, make us more accessible and flexible and able to take emerging trends into account in our regulation more quickly. The Capital Markets program I have outlined today will be a significant part of the ASIC's presentation to the market.