



ASIC

Australian Securities & Investments Commission

AIRA Annual Conference 2009

Playing by the Rules:

A new regulatory environment is changing the way that corporations relate to investors and the finance community

Belinda Gibson, Commissioner of ASIC
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Good morning. Thank you for this invitation to again present to your annual conference today.

AIRA is an important stakeholder organisation for ASIC. Like ASIC and the ASX, you are very focused on providing the best information about listed companies to the marketplace. That of course is critical to promoting market integrity.

Last year my presentation was about disclosure in a stressed economy – dealing with bad rumours and announcing profit downgrades. What a difference 12 months makes. I have just come back from Perth where the market has gone wild again. The Terrace is back, they will tell you, saving us from the recession we didn't have but were mighty worried about.

Opening

My topic today (I should say given, not chosen, as it's a mouthful) is "Playing by the rules: a new regulatory environment is changing the way that corporations relate to investors and the finance community".

I propose to start with a brief outline of ASIC's priorities in the current regulatory environment, to set some context for the balance of my address.

Then I will look at the market environment. There are two themes that frame the communication conundrum that you face:

- 21st century technology enables the provision of enormous amounts of data to everyone, quickly and relatively cheaply. But is all that data useful or capable of comprehension?
- The biggest investors in our markets are well resourced, sophisticated and devour information. Where does that leave the retail investor with less knowledge and less time?

After a brief foray into the principles of "clear, concise and effective", I want to raise some ideas that I hope might lead to a discussion about improving the efficacy of prospectuses and annual reports. Finally I will close with a gentle reminder about the importance of securing confidential information.

The regulatory environment - three key ASIC priorities

First, the regulatory environment that ASIC oversees. At the start of this year ASIC set for itself a number of priorities. These included (and will continue next year to include) three key market facing priorities that I want to take you through, in terms of what we have done, and plan to do.

One priority is to manage the domestic and international implications of the GFC.

The GFC has seen significant losses to many investors, both at institutional and retail levels.

In the United States and Europe many of the (once) enormous banks designed, sold and then invested in each other's sub-prime mortgage structures, known as CDOs. Once the truly "toxic" nature of CDOs became clear they had to be sold, though the market had become wiser about risk and the direct but inverse relationship of risk to value. There followed the downward spiral of prices for these instruments and in turn the prices of securities of the holders of those instruments.

That is a very brief and superficial snapshot of the start of the GFC. There have been a host of meetings of Heads of State and Treasurers, through the G20 and the Financial Stability Board, to address the regulatory gaps that the GFC has exposed.

The focus of the G20 participants is developing common principles. It is critical to ensure consistency of approach across all competing jurisdictions to prevent regulatory arbitrage – the flight of investors to a home that imposes the least regulation or, in other words, the greatest scope for unsupervised exploitation. Uniformity is not practical or possible, but every major market must at least be in the same zone.

Australia is an active participant in these fora. The Chairman of ASIC is on the technical (ie leadership) committee of IOSCO and is represented on many of the specialist committees. During the past 12 months we have taken a number of steps to align our regulatory position with that of leading overseas markets – short selling rules, reform of regulation of credit rating agencies, and review of the OTC markets' framework are examples. Work will follow on hedge funds and securitisation. The focus of each project is to give regulators, and the broader market, access to more information.

Our second priority is to protect the retail investor. Global regulator attention is not confined to the big end of town. The position of the consumer is also under review in all the leading markets.

Over the last 18 months in Australia there have been a number of corporate failures that have exposed retail investors to significant loss - to name a few, Storm, the agricultural managed investment schemes of Great Southern and Timbercorp and, in a different respect, stock market investors with Opes Prime.

ASIC has expended considerable resources through the period of the GFC to examine these failures, and many others. We look to take action to protect the position of investors and, where it is available, to restore value to them.

It is apparent from our discussions with some retail investors in all these cases that many did not have a proper appreciation of the key features of the products and services they were buying. Perhaps they did not understand the counterparty risk, or the commission structure, or the inter-linkage of their investment to other market events. Most had received a PDS or prospectus, or a financial adviser's statement of advice, but that had not really improved their knowledge.

Our regulatory framework is premised on disclosure. The law mandates the manner, timing and content of disclosure. This regulatory structure assumes financial literacy of the reader, so that the material disclosed is understood and is sufficient to enable sensible assessment against the objectives of the investor.

This assumption of literacy has been tested by the GFC. The most sophisticated investors in the (formerly) big banks clearly did not understand what they were investing in. What hope had the retail investor? We are taking steps to promote financial literacy, but that is a inter-generational project.

As the GFC rolls into the recovery phase and new financial products are hitting the market, ASIC will be reviewing the adequacy of disclosure, particularly from the viewpoint of the retail investor. Australian retail investors seem to be offered far more complex (read risky) products than their counterparts in the northern hemisphere. These products warrant clearer disclosure about the pitfalls than is afforded them at present. We have in plan a series of regulatory guides that will be

quite clear about what we think is relevant and necessary disclosure for particular product types.

Our third priority is promoting confidence in market integrity. Market integrity is a shorthand term for the features of transparency and fairness of a market. Confidence in the integrity of a market is crucial to attract and retain investors into it.

Will it surprise you that good disclosure is an essential attribute of a market "with integrity"? This means disclosure of information about an investment in the initial offering material and also ongoing disclosure of current information to the market. It is both the quality of information as well as the quantity of information which is crucial in determining whether disclosure advances the transparency and fairness of a market.

Market confidence and the retail investor

To highlight my point that good disclosure is critical to investor confidence and a matter of concern to all regulators, I have included a quotation from Mary Shapiro, the Chairman of the SEC. The highlighting is mine – I suggest you need to come back to these words every time you look to assess the quality of market disclosure.

"If investors cannot obtain important and accurate information necessary for them to judge the financial soundness, management and prospects of an enterprise, they are more likely to make poor decisions – or perhaps choose not to invest at all. Indeed, during the crisis, investor confidence in the transparency of the markets, sufficiency and even the reliability of the information they were getting was shaken to the core. In too many areas, investors could no longer be certain that they were getting clear, relevant and reliable information about their investment options. Because investors could no longer discern a clear picture of the risks they were taking, many exited these markets."

ASIC embraces Mary Shapiro's concern that to secure long term reinvestment in our capital markets we need to promote the quality of disclosure to the market and to investors. We need to do this for the benefit of all investors.

Disclosure: new regulatory environment

I will move now to the communicator's conundrum. In October this year Bill Lutz spoke at an AIRA forum in Sydney entitled "The coming revolution in shareholder communication". His theme was the need for companies and regulators to use the web to make as much information as possible available to everyone, in a form that enables analysts to search and sort it how they wish.

He drew a distinction between:

- data – which is facts,
- information – the meaning assigned to facts, and
- knowledge – the ability to use information.

These I think are key concepts for us here in this room as we address better communication with the financial community. Today there is an abundance of data available to investors, sourced from the company itself, from professional analysts and commentators and, probably less reliably, from interested bystanders running blogs or tweeting to their followers. It is, I am sure, a challenge for you as investor relations managers to monitor what the market is saying about your companies, just as it is for us and for the ASX.

While we have data overload, is there enough information? Information requires analysis. Analysis assumes a context – should an investor buy or sell? Should a shareholder approve a takeover offer? Mr Lutz put the proposition that company management should do more analysis for investors than at present. I tend to agree.

The worldwide web presents many challenges for ASIC. One is how far should ASIC go in permitting electronic disclosure documents, such as prospectuses or PDS to be delivered by email. Such an email could provide a link to a website that would host a bundle of documents, potentially without limit in volume. Is it possible that this vehicle could be misused? Could a company just dump every annual report and continuous disclosure notice ever lodged on to the website and say – "well we gave

you every bit of data we have, so you can't complain"? Could a company prepare a statement of risks in the clearest terms, but hide it three mouse clicks away from the entry page? "It's there, so don't complain."

These issues must be addressed by the finance and legal industry, and ASIC is starting to open that dialogue. There will need to be some recognition that the key features of the offer, and the analysis of it, need to be readily available to the investor, on paper or just a click away.

What is it that the investor needs to know? That of course will depend on the context. For an IPO probably it is as simple as:

- what does the company do and what are its plans for the future?
- how does it make money?
- what are the risks to it making money?
- who are the competitors?
- what are the offer features?
- who are the directors and what is their experience?

The degree of detail required will depend on the investor. The investment institution clearly has an enormous appetite for detail – financial models, customer profiles and supply costs. Most retail investors have neither the time nor the resources to absorb this data and turn it into useful knowledge to make informed investment decisions.

To whom should the offer document be pitched? There is of course no simple "regulator says" answer to this problem. I do think, however, there is great scope to improve how a disclosure document is put together to assist investors of varying skills and desire for data to access what they need to inform themselves.

To combat the undue length of paper documents, the concept of "clear, concise and effective" was introduced into the law in 2004 for some disclosure documents. Where would we be without that initiative? Prospectus and takeover and scheme documents can still run to hundreds of pages. In contrast to overseas offerings, the written

English in our disclosure documents is often "plain" but the message is not always clear. One has to ask the questions – who reads these documents? Who understands them? Can they convey their message in a better way?

There are two attributes to focus on when drafting a "clear, concise and effective" document.

The first element is content – is all the information provided relevant and useful? Is there too much information that is not material to the decision at hand? Is there sufficient analysis, rather than just data? Are the pros and cons (ie risks) clear?

The second element of "clear, concise and effective" – is the layout of the documents. Can a reader readily locate the information they need? A road map to offer documents can be a very useful tool.

The disclosure continuum

The Corporations Act establishes a clear regime for disclosure to the public market, from go to woe.

- The IPO prospectus or product disclosure statement for an initial offering.
- Continuous disclosure updates - you all know the rules I am sure: the market must be told all material price sensitive information immediately, unless the carve outs in the ASX Listing Rules are available.
- Annual reports that include the audited financial statements, the remuneration report and a directors' statement that describes the business in more qualitative terms.
- Shareholder documents to consider "company transforming" events such as capital raisings, change of control transactions, significant acquisitions, related party dealings and, to close the cycle (the woe), winding up.

Of course a company makes other statements to shareholders and the market during the course of a year. Perhaps the most informative material is provided at the investor analyst briefings that usually occur when the annual and half yearly results are

announced. These materials are usually approved by the board. A number of directors have told me they spend as long on this document as the audited accounts. It is usually prospective and looks over the company's business model and analyses the various segments.

The "clear, concise and effective" prospectus!

I would like now to make some specific comments about the fund raising documents. Capital raisings have resumed. The prospectus is meant to tell investors everything they and their advisers reasonably require to make an investment decision. They are intended to be read, and understood, by both retail and institutional investors.

As I have said, I think the financial community needs to discuss the quality of today's IPO documents. Are they too long and too focused on promotion of the product? What relevance are photographs of offices, trucks, or sales staff to the investment decision? Are the risks of investing plain enough and sufficiently near the front to be read and understood by the average (read average retail) investor? Is the prospectus a "tick the box" exercise that is dominated by the lawyers and their precedent templates?

I have gathered a list of the kinds of issues ASIC often encounters in reviewing prospectuses. As an aside, these comments can apply to almost every type of disclosure document we see at ASIC.

- First, poor disclosure of the investment proposition – it can be surprisingly difficult to grasp in many prospectuses exactly what is the financial product offered or what is the business model of the issuer.
- Risk disclosure that is buried, or bears no real relationship to the actual risks associated with the particular investment. We often see the same precedent of risks appearing in prospectuses for very different businesses. It is difficult to understand which are the real risks and which are the remote risks. How often do you see a ranking of risk in a prospectus? We expect a company's board to identify risks and rank them by reference to possible impact and likelihood of

occurrence. Would this be useful to an investor? At a suitably high level I don't think it's going to damage the company to release it.

- Another complaint, the use of jargon and glossaries, where understanding each page necessitates flicking to a definition somewhere else in the document.
- Omission of material information. There is often a lack of information about the fundamental assumptions underlying a particular statement. Can I say, this is particularly concerning in the mining and resources sector at present. That market has taken off in the last few months. Our Perth team is working very hard to pin down some very sweeping statements about resource quality and valuation possibilities. Our copies of the JORC Code are well thumbed.
- Less than plain statements about the benefits that promoters, significant shareholders and executives stand to make out the company or the float transaction itself. Are these people also customers or lenders or borrowers to the company, even on what the promoters think are arm's length terms? An investor should know this.
- Finally, repetition, repetition, repetition. Sometimes we see the same information presented over and over again – first as one sentence, then as two or three, then as a paragraph or two and then towards the back of the document as a page. "Clear, concise and effective" is not just a series of summaries of varying degrees of brevity.

Readability of a prospectus is key for investors. This is what the legal requirement of "clear, concise and effective" is aimed at. In many cases the length of a document can present problems. But short documents can suffer from problems too, particularly if poorly presented and worded. Investors need sign posts, and possibly a road map, to navigate their way through information. The words are part of this solution but design and layout are other factors that can assist.

ASIC will be providing more guidance to the market on this topic in the next 12 months.

The complete and useful annual report

As the annual report season draws to a close, it is timely for the corporate community to consider the overall quality of the annual report. I am told that few shareholders of the major companies now request the long form annual report – which is good for the environment, but is it good for the market?

The assumption of the disclosure regime we operate in is that the annual reports are a comprehensive update from year to year, displacing the IPO document and intervening continuous disclosure notices in terms of providing relevant and current information for investors. Are today's annual reports useful disclosure documents for an investor in the company, or just promotional material covering the fairly extensive statutory requirements? The fact so few are requested from companies suggest that are not fulfilling a need – unless of course they are all avidly read on the internet.

If a company wishes to serve its investors well, I suggest to you it should aim to provide an annual report which communicates effectively with investors rather than just ticks all the required boxes and includes some attractive graphics. The annual report is the once a year opportunity a company has to take stock of its position and report back to its investors. It is the opportunity to articulate its forward strategy to investors in a comprehensive and comprehensible manner.

The Corporations Act requires reference to likely developments in the company's operations in future financial years. The information provided is sometimes so formulaic that it communicates very little to the reader. The analysts briefings to investors released with the annual results are often more informative in this regard. I suggest that at the very least that information should be included in annual reports.

While continuous disclosure is important, by its very nature it is piecemeal. It can be difficult for investors to form a complete view of an entity on the basis of continuous disclosure releases of varying importance. Our regime can only work effectively if financial reports, and in particular the annual report, provide an opportunity for investors take stock of the company as a whole. The annual report has a prospectus like function for investors who are trying to decide whether to buy, sell or hold shares in the company.

ASIC will look to have a dialogue with the market on this question in the coming year, particularly in the context of relief that is sought for issuing long form prospectuses for new issues. It will be raised in our listed debt product consultation paper due in the next week.

Confidential Information

Ladies and gentlemen, we seem to have been able to go through most of today's presentation without mention of that key market requirement of continuous disclosure. I will however make just a brief comment.

As you all know, material price sensitive information must be disclosed to the market immediately the ASX carve outs fall away. A critical component of the exemption is that the information is confidential. There are two questions of fact to be answered. First, do the arrangements between those who know this information require confidentiality and, secondly, is the relevant information still secret from the market?

During the past year we have been concerned about the number of price falls before capital raisings. In recent months we have been looking back at suspicious price and volume changes that occurred before takeover bids.

While these movements may have been the result of the volatile market conditions at the time, it has raised concerns around the practices of market participants in handling confidential information.

ASIC has responded by not only pursuing a series of investigations into particular apparent leaks, but also by commencing a project to examine market practices in handling confidential information. We have met with many companies and their advisers to find out what systems they have to protect confidential information prior to the announcement of price sensitive transactions such as a fundraising or an M&A deal.

As a result of this work, we believe there needs to be greater focus and control over how confidential information is handled by companies both within their own organisations and externally with advisers and other service providers. We will shortly release a set of best practice guidelines for the handling of confidential information, for consultation. Our objective in releasing best practice guidelines in this area is to encourage better practices across the market and ensure leaks of confidential information are reduced to the maximum extent possible. This will be important for you here in this room who have to manage disclosure at the front line.

Closing

I would like to close now. Just to recap briefly:

- Australia does not have, nor need, a whole new regulatory framework. We are working to adapt it in line with international principles.
- A key focus of ASIC in the next 12 months will be on improving the quality of disclosure to the market, particularly adapting it to ensure the retail investor is protected.
- The market needs to be better at making documents "clear, concise and effective". This means they must be readable – if they are lengthy, there must be a clear road map to enable the reader to select the information he needs to make a sensible investment decision. The documents must be understandable. The content must be clear and relevant to the investment decision at hand. The risks must be put up front and in one place.

I would welcome a dialogue in the marketplace about these issues and, in the nearer term, am happy to take questions.