

Continuous disclosure— outcomes vs enforcement

The need for an efficient system of continuous disclosure is beyond debate. The only problem is arriving at a workable solution that serves the needs of the market and keeps both the regulator and companies happy. **ANDREW LUMSDEN** discusses the issues.

Since 5 September 1994, continuous disclosure by Australian listed companies has been the foundation upon which much of our scheme for the efficient regulation of markets has been based.

The overriding principle of our scheme of regulation is based on a sharing of regulatory responsibility between the Australian Stock Exchange (ASX) and the Australian Securities and Investments Commission (ASIC) and the powerful disinfecting quality of sunlight: a philosophical belief that generally a well-informed and efficiently operating market is best positioned to discipline aberrant behaviour.

The general consensus is that the continuous disclosure regime for listed companies administered by the ASX is operating efficiently and effectively.

While the current arrangements work satisfactorily they could be improved. Using the revamped Takeovers Panel as a model, the Commonwealth Government could establish a new Disclosure Division of the Takeovers Panel.

A Disclosure Division would be responsible for determining whether there had been any failure to comply with the continuous disclosure requirements by reference to the ASX Listing Rules and the Corporations Act. The Disclosure Division would not supplant ASX's front line regulatory role. Proximity to the market is essential to its flexible and responsive

monitoring of the continuous disclosure framework.

The ASX's current systems allow the great majority of continuous disclosure issues to be administered in real time and on the basis of a detailed knowledge of the company, the industry and the market.

The Disclosure Division would comprise individuals with sufficient talent and understanding of the market to provide insights into disclosure practice by reference to best practice.

The Disclosure Division ought to comprise, inter alia, representatives of the ASX, disclosers (i.e. listed companies) and users (i.e. investors, especially institutions).

It is important to remember there is considerable disagreement as to what is appropriate in various circumstances. The Disclosure Division would be a better forum to resolve this uncertainty.

The Disclosure Division would be designed to act with speed and to apply a uniform standard to questions of compliance with continuous disclosure obligations.

The Disclosure Division could also issue guidance notes or similar and look at issues of how webcasts or online postings can enable companies to fulfil their disclosure obligations.

Similarly it could address matters like investor relations practices to try to cut down on leaks of price sensitive information to newspapers and suggest ways of dealing with analysts and/or journalists.

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This model is to be contrasted with calls by ASIC Chairman David Knott for ASIC to be granted power to fine listed companies for breaches of continuous disclosure and other market offences.

The ASIC fining proposal sees the problem with our existing scheme in terms of enforcement.

In the context of this debate it is useful to remember that much of what the regulators are reacting to are matters falling into two broad categories:

- *Briefings*: circumstances where it is alleged that a company's officers have selectively briefed analysts; and
- *Press speculation*: generally these matters take the form of responses to ASX queries in relation to market or press speculation. The issue is whether market speculation can contaminate an otherwise confidential transaction such that the exemption in ASX Listing Rule 3.1.2 no longer applies.

Purpose of mandatory disclosure rules

In 1992 the Commonwealth Government introduced the original legislative provisions governing our continuous disclosure regime.

At that time it was hoped that the provisions would lead to a better informed market and "greater investment confidence and in turn a greater willingness to invest in Australian business".

The thrust of material emanating from government, ASX, ASIC and investors is grounded on the role of disclosure to deliver an efficient, competitive and informed market where shareholders have an equal opportunity to participate in the market.

However, our disclosure rules do have an emphasis on monitoring, e.g. disclosure of directors' shareholdings etc, preparation and lodgement of substantial shareholder notices and proxy voting.

There is a substantial body of research concerning the possible benefits of a scheme of mandatory disclosure, but it is fair to say that as yet there is little strong evidence that the regime had any significant impact on the efficiency of the market operated by ASX or on the disclosure policies of listed companies.

Most likely this is because the "new" 1994 provisions didn't change the nature of the reporting obligations, although it did create new penalties for non-compliance.

Similarly, the ASIC fining proposal will not create one new obligation, nor will it provide guidance for continuous disclosers. The research does not support the need for a new penalty scheme; rather the research supports the need for a fresh look.

Recent evidence suggests that some of the smaller companies listed on the ASX are not satisfactorily complying with the continuous disclosure regime; however, this is not new. Research has consistently found that smaller companies are generally more likely to need to be forced to reveal previously undisclosed information.

Wherever you sit on the academic debate concerning the effectiveness of continuous disclosure, the reality is that the debate has moved on, both here and in the US. In this environment Australia has a strategic imperative to protect and enhance market integrity.

Australia represents only 1.59% of global capital flows. To survive and grow in a globally competitive environment, Australian capital markets need to attract foreign investment and to engage retail capital. Continuous disclosure plays a vital part in providing investors with confidence, building depth and liquidity in the Australian market.

Over and above the global market issues, the particular nature of the Australian market is that more than 50% of Australians own shares. Smaller investors are likely to feel less vulnerable where they believe the market is conducted with fairness and integrity and where services are provided efficiently.

The continuous disclosure regime is perceived as an important part of the process of ensuring that the market is informed at all times and that no investor is disadvantaged by lack of access to material information.

If the primary purpose of the mandatory disclosure provisions is to create an informationally efficient market where prices fully reflect all publicly available information, how

does the ASIC fining proposal enhance that objective?

While disclosure might not have changed qualitatively since the introduction of mandatory disclosure, anecdotal evidence would suggest there is generally a real attempt to comply with the spirit behind the regime, certainly among larger companies.

The problem is that the application of ASX Listing Rule 3.1 is not clear cut. (*It is the reason ASX has just released a discussion paper on changes to this rule.*)

Many of the concepts that disclosing companies have to deal with under the continuous disclosure provisions are very difficult.

A further issue for a listed entity is that there are very few published decisions, either from the courts, or from ASIC or ASX, about the interpretation of Listing Rule 3.1 and the continuous disclosure obligations.

Financial Services Reform Act

Since 11 March 2002 the continuous disclosure regime has been substantially amended, inter alia, to take account of the changes made to the Corporations Act by the Financial Services Reform Act 2001, as well as the recommendations of the 1996 CASAC Report on Continuous Disclosure.

The main changes to the continuous disclosure regime relate to recasting the primary obligation from a negative obligation (not intentionally, recklessly or negligently failing to make disclosure) to a positive obligation (requiring disclosers to notify the market operator). Additionally, s 674 no longer requires that ASIC establish that the failure to make disclosure was intentional or reckless.

Failure to comply with obligations to disclose in accordance with the listing rules remains an offence, and in line with the approach taken for many of the disclosure misconduct provisions, contraventions are also subject to civil penalty provisions.

Additionally, a court may compel compliance with the ASX Listing Rules, suspend trading in particular securities and/or make an order that the offender pay a pecuniary penalty if they materially prejudice the interests of acquirers, disposers or the issuer of the financial products.

LOW					HIGH
Call from an ASX officer	ASIC investigation leading to enforceable undertaking	Civil remedies by a person who suffers loss or damage	Civil penalty order	Pecuniary penalty order	Penalty of 200 penalty units or imprisonment for 5 years or both

Gradient of the Australian current enforcement regime.

This means that the prosecution of a possible breach of the disclosure regime has a wide range of alternative processes ranging from administrative action (eg ASX officers contacting the discloser) to gaol, yet ASIC claims it needs a further prosecution remedy.

Australia has an enforcement regime that offers the regulators a range of alternative prosecution options to curb aberrant behaviour. The alternatives are flexible depending on the nature of the apparent offence.

The appendix sets these out in a little more detail for both periodic and continuous disclosure matters by listed

companies. The table shows that although they receive much less focus there are substantial ongoing periodic disclosure obligations on a listed company.

If ASIC is genuine about improving the corporate culture of disclosure to address the “cultural clash between regulators and modern business practices”, they might do better to focus on enforcement of the more prosaic periodic reporting obligations rather than the more glamorous (newsworthy) obligations under Listing Rule 3.1.

A policy of “zero tolerance” and aggressive enforcement of existing periodic reporting obligations might do

a lot more to promote a culture of voluntary disclosure and compliance than recent attention by ASIC on companies like National Australia Bank, AMP, AXA, WMC and Southcorp.

ASIC’s argument in favour of a penalty power

In recent months ASIC has been arguing in favour of a power for ASIC to fine for disclosure offences such as late or inadequate disclosure.

In ASIC’s view there are “instances of unacceptable information leakage, and late or inadequate disclosure, from companies of substance and experience that are inexcusable in light of the publicity and exposure directed to these issues over the past 18 months”.

ASIC’s view is that a new civil penalty regime for disclosure offences including the continuous disclosure provisions alone will not deliver the necessary ‘sharp end’ to deal effectively with issues like late disclosure or partially inadequate disclosure.

In an argument that seems to have more to do with “me too” than global harmonisation, ASIC also argues that in the UK the Financial Services Authority (FSA) has been given considerable powers to levy financial penalties.

ASIC acknowledges the role of the ASX as having front line responsibility for ensuring continuous disclosure, but believes that “a power by ASIC to impose fines of substance would add discipline to the market’s processes – not just because of their financial impact but more importantly perhaps through their public nature” and the ability to institute a quick regulatory response.

Arguments against ASIC fining power

The obvious problem for the ASIC fining proposal is that the imposition of a fine or penalty for breach of a legislative provision could be construed as the exercise of judicial power.

Under the Constitution only courts can exercise the judicial power of the Commonwealth, i.e. only courts can impose fines or penalties for breach of a Commonwealth law. For this reason it is highly unusual for a



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regulatory body in Australia to have the power to impose fines directly without going through the court process, to be as it were investigator, judge, jury and executioner.

There are some ways around this restriction; on the spot fines is one example (e.g. for traffic offences). In that case a person can go to court, or instead elect simply to pay a fine to avoid having to argue the matter out in Court. Ultimately, however, such fines are enforceable by the courts.

While the aim of a pecuniary regime may be "fast and flexible" resolution of financial market contraventions, the issuing of a fine, particularly in the case of an individual, is likely to be vigorously defended, where reputations and fines large or small are at stake.

Ultimately, fining in these circumstances would most likely lead to the same outcome, in the same time frame, as action taken under the civil penalty provisions.

If ASIC uses fines as a way of subverting the requirement to establish proof or intent, a rather different issue arises, namely: accountability, transparency and fairness on the part of ASIC.

ASX Listing Rule 3.1

Beyond the arguments raised by ASIC it is important to remember the nature of the problems that have emerged in this field. This issue is largely about the enforcement of ASX Listing Rule 3.1, a provision that is somewhat "aspirational".

Like all the ASX Listing Rules, Rule 3.1 needs to be read (whatever its

detail) by reference to the spirit, intention and purpose of the ASX Listing Rules and by looking beyond form to substance.

The court is supporting the view that the ASX Listing Rules are not the kind of rules that ought to be enforced by a regulator like ASIC or that are traditionally associated with offences which are the subject of penalty notices.

The necessary vagueness of ASX Listing Rule 3.1 makes it unsuitable for a regime built on the imposition of a fine. Fining regimes are better suited to matters where the breach can be easily determined, offences of strict liability e.g. failing to lodge a half-year report (Appendix 4B) within 75 days of the end of the accounting period.

The proper application of ASX Listing Rule 3.1 will almost always be a fine question of judgement. Determining whether press speculation about an impending transaction has meant that confidentiality has been lost is not the sort of matter that ought to be subject to the determination of ASIC officers.

Functions of the Disclosure Division

Leveraging off the significant and measurable success of the Takeovers Panel as part of the CLERP takeover reforms⁵², the "Disclosure Division" (possibly, provided they had additional funding utilising the Takeovers Panel, with its existing infrastructure) could be established under the Australian Securities and Investment Commission Act 2001 and/or the Corporations Act

to perform a non-judicial function related to disclosure misconduct.

The Disclosure Division would administer the spirit of the disclosure misconduct provisions of the Corporations Act and in particular by virtue of s 674 ASX Listing Rule 3.1. The Disclosure Division would be guided in its determination by broad considerations of policy of the kind described earlier in this paper and the public interest.

The Disclosure Division would be able to operate in an environment that focused on the need for:

- decisions to be made in as near to real time as possible. If the Disclosure Division is going to work it must be capable of instituting a rapid response to potential contraventions;
- decisions regarding disclosure ought to reflect the expectations of regular market users and ensure that we are in tune with international best practice. With appropriate appointments, the Disclosure Division would be very conscious of the need to demonstrate that our market standards were in line with world's best practice so that international investors do not discount investing in Australia;
- standards that tackle cases of breach on the basis that they pose a material threat to confidence in Australia's equity market. As the FSA's Howard Davies recently observed, "Market manipulation is not a victimless

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APPENDIX

OBLIGATION— CONTINUOUS DISCLOSURE	COMMENT	PENALTY
<p>Rule 3.1 obliges an entity to immediately tell the market about any information that a reasonable person would expect to have a material effect on the price or value of the entity’s securities.</p> <p>Additionally, all listed entities must have a person responsible for communication with ASX.</p>	<p>The application of ASX Listing Rule 3.1 is restricted in a very limited way in certain circumstances eg where a reasonable person would not expect the information to be disclosed, the information is confidential and it would involve a breach of law; or is somehow incomplete; or is insufficiently definite to warrant disclosure; or is only for internal consumption; or is a trade secret.</p>	<p>Under ss 674-678/Chapter 6CA of the Corporations Act and the ASX Listing Rules by virtue of s 111AE of the Corporations Act whilst an entity is included on the official list of the ASX it is required to comply with the ASX Listing Rules and Rule 3.1 in particular.</p> <p>The ASX Listing Rules do not have statutory force but the Courts can enforce compliance with the rules.</p> <p>Suspension of an entity’s securities, or a class of them, from quotation.</p> <p>Removal of an entity from the official ASX list.</p> <p>Civil penalty provisions, such as a declaration of contravention, pecuniary penalty order, compensation order, or ASIC may prosecute in criminal proceedings.</p>
<p>No pre-emptive release of information filed with ASX.</p>	<p>Entities are prevented from disclosing information that is for release to the market to any person before it is disclosed to ASX.</p>	<p>As above.</p>
<p>Disclosure of information related to buy-back offer.</p>	<p>Entities are required to disclose a variety of information related to the announcement of, any change to and the final notice of a buy-back offer in accordance with Appendices 3C, 3D, 3E, and 3F.</p>	<p>As above.</p>
<p>Disclosure of directors dealings with securities.</p>	<p>Any change to a notifiable interest of a director must be disclosed in accordance with Appendices 3X, 3Y, and 3Z.</p>	<p>As above.</p>
<p>Disclosure of information relating to take-overs.</p>	<p>Documents and information pertaining to a takeover bid by an entity.</p>	<p>As above.</p>
OBLIGATIONS—PERIODIC DISCLOSURE		
<p>Annual and half yearly financial reports Quarterly cash flow report.</p>	<p>In addition to the Corporations Act obligations Chapter 4 of the ASX Listing Rules requires a preliminary final report in the form of Appendix 4B.</p>	<p>Suspension of an entity’s securities, or class of them from quotation (this remedy may not be waived) .</p> <p>Removal of an entity from the official ASX list.</p>
<p>Quarterly cash flow report.</p>	<p>Some entities have obligations to give quarterly cash flow reports in accordance with Appendix 4C.</p>	<p>Suspension (this remedy may not be waived).</p> <p>Removal of an entity from the official ASX list.</p>

OBLIGATION— PERIODIC DISCLOSURE	COMMENT	PENALTY
Information relating to equity securities.	Entities must disclose detailed information relating to the issue, ownership, attached rights of securities.	Suspension of an entity's securities, or a class of them, from quotation. Removal of an entity from the official ASX list.
Trading halts and related events.	Entities must disclose all relevant information in relation to a request for a trading halt, suspension of quotation of an entity's securities or removal of an entity from the official list.	As above.

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crime. Other investors have bought or sold at false prices and the credibility of the market is damaged for all its users.”;

- decisions that provide authoritative guidance to disclosers including issuing guidance notes, which the Disclosure Division would be in an excellent position to produce. One of the problems at the moment is that there is precious little guidance as to what is considered appropriate disclosure;
- all investors to have equal access to price sensitive information;
- there to be a constant flow of high quality information about listed companies to investors;
- a better culture of compliance with continuous disclosure but one that recognises the need to balance the interests of individual shareholders and the needs of the market generally; and
- individual officers of disclosing companies to appreciate the importance of compliance and the possible personal consequences of non-compliance. To reinforce this the Disclosure Division would probably need to have the power to make orders concerning individual officers involved in contraventions rather than the entity, on the basis that what hurts the entity hurts its investors who may themselves have been harmed by non-disclosure.

If satisfied that there had been an unacceptable failure to properly inform the market and where it was in the

public interest to do so, like the Takeovers Panel, the Disclosure Division would be entitled to make declarations and orders concerning the subject matter of the investigation.

The Disclosure Division could utilise the kind of procedures used by the Takeovers Panel to enable it to act quickly enough to remedy non-disclosure.

Like the Takeovers Panel, the declarations and orders of the Disclosure Division would be subject to judicial review and would not be binding in the sense that a judicial determination is binding. An application would need to be made to the court to enforce the orders made by the Disclosure Division.

While ASIC would be free to apply its resources to the preliminary investigation of a possible failure to comply with disclosure misconduct provisions, it would not be a necessary precursor to bringing a matter before the Disclosure Division.

The Disclosure Division would have a number of functions, it could:

- settle disputes between the ASX and listed entities over questions of interpretation, thereby enhancing the co-regulatory model by providing a market based scheme for enforcement of the ASX Listing Rules;
- perform a remedial function in relation to a misinformed market by making a finding of an uninformed market and requiring disclosure/compensation; and
- impose sanctions against contraveners.

The intention of the new Disclosure Division would not be to supplant the current jurisdiction of ASIC to

determine civil claims and the civil penalty provisions or ASX to conduct frontline supervision, but rather to provide a mechanism in appropriate circumstances to ensure, promote and encourage “...the provision of price sensitive information to the market in a timely fashion [and the] ability to institute a quick regulatory response to contraventions of the continuous disclosure provisions...”

Conclusion

While the current arrangements work satisfactorily there is scope to improve the provisions, not through a new penalty provision, but rather through the establishment of a new Disclosure Division.

The Disclosure Division would be designed to act with speed and to apply a uniform standard to questions of compliance with continuous disclosure obligations.

The Disclosure Division could be constituted by a wide range of stakeholders to ensure it had the necessary expertise to review conduct by reference to market practices and to reflect the aspirational nature of our current continuous disclosure regime.

The Disclosure Division could determine whether there had been any “unacceptable disclosure practice” having regard to the spirit of the market misconduct provisions.

Author's Note: The notes to this article have been removed in the interests of brevity. To review a copy of this article including notes, visit www.corr.com.au