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# Orderly Share Trading Adds to Confidence

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Should the boards of listed firms be at all concerned about volatility in the price of their companies' shares?

In theory, a listed company has no proprietary interest in the profits or losses arising from trades of its shares, so it can be argued that such volatility need not be an issue.

In practice, however, the market price of shares is often seen as a proxy of the intrinsic value of the company. Therefore, excessive and prolonged volatility may be perceived as a sign of the company's instability and can have a negative impact on its public profile.

The consequences may lead to other undesirable outcomes for the company, including distracting management and the board from

responding to operational and business issues, raising the cost of funding and, in the longer term, talent retention.

## WHEN LISTED COMPANIES SHOULD CARE

Share-price volatility is generally not an issue when capital markets operate efficiently and where there is adequate disclosure of material information by companies.

However, where excessive volatility results from non-systemic market forces at play, then boards should be wary of the share price. Such excessive volatility could be caused by rumours, price manipulation, confidentiality leaks, misleading research reports and high-frequency trading.

If rumours which turn out to be false are causing share price volatility, the listed company should act quickly to clarify its position with a clear and timely announcement. Singapore Exchange (SGX) rules require that an issuer clarify or confirm a rumour if it is "necessary to avoid the establishment of a false market". Companies should not remain silent by simply claiming a corporate policy of not commenting on market rumours.

Where price manipulation is suspected to be behind price volatility, the source of the mischief should be sought out and identified. Under the Securities and Futures Act, false trading and market-rigging activities, including wash trades, are prohibited. The board needs to be vigilant in monitoring unusual price changes and put in place measures to minimise any possible price manipulation by insiders. If there is evidence of any such manipulation by insiders, directors may need to conduct an internal investigation, obtain professional advice and report the suspected manipulation to the authorities.

Price volatility may also result from the leaking of material, non-public information. It is imperative that strong internal controls

are in place to prevent any such leakages. Confidential information should only be released to a compiled list of identified staff, strictly on a need-to-know basis. All recipients are also to be reminded of the company's confidentiality policies, and to observe insider trading laws.

In takeover situations, the boards of both the offerors and the target companies should be clear about their confidentiality and announcement obligations. Undue movements in share price and trading volume can precipitate an untimely, unintended transactional result unwelcomed by both parties.

Speculative or misleading reports from third-party investment or broking houses can spark price volatility. The board should determine whether the reports contain any material falsehoods or misrepresentations that may justify taking legal action. If necessary, the board should request a trading halt or a voluntary suspension to enable a clarification announcement.

Misleading reports may also signal a need for more effective investor relations and communications.

In other markets, high-frequency and algorithmic trading can trigger sharp-price changes. This recent trading development has been hotly debated. Detractors claim it leads to potential distortions of prices and enhances flash crashes. Proponents champion it for lowering transaction costs, increasing liquidity and enhancing market efficiency. If such trading becomes prevalent on our shores, checks and balances need to be put in place to regulate such trading as well as the closer monitoring of the consequences of such trading behaviour.

## REGULATING SHARE PRICE VOLATILITY

Regulators generally keep a wary eye on significant share-price movements.

However, recent episodes of sharp price movements in certain penny stock counters have led to further SGX rules in this area. The rules will take effect from March 3, 2014.

Any unusual trading activity will typically prompt a stock exchange query. Under the new rules, the board of directors is required to approve a reply to a public query by SGX. The exchange will also issue a "trade with caution" announcement when the company is unable to explain the unusual trading activities.

Where unusual trading activity reveals a threat to fair, orderly and transparent trading, curbs may be imposed, including suspension or designation of the listed company's shares. Regulators may also conduct further investigations where potential market misconduct is detected.

In summary, boards today have no choice but to exercise vigilance in monitoring price volatility. Ultimately, the maintenance of orderly trading in company shares will add to market confidence in their listed companies. ■