[FSCA hits Viceroy with R50m penalty for false, misleading statements on Capitec]

Will the FSCA's R50m fine on Viceroy have a chilling effect on research?

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Yes, says Viceroy – and that makes it less likely that the next Steinhoff will be picked up ahead of time.

By Ciaran Ryan 14 Sep 2021

The obvious intention of the law is to prevent market manipulation under cover of research, but subjectivity is an issue.

Analysts and research teams focused on South African stocks will no doubt be revisiting many of their recommendations – buy or sell – in light of the Financial Sector Conduct Authority's (FSCA) imposition of a R50 million fine on Viceroy Research last week for a series of 2018 reports on Capitec that were deemed to be false or misleading.

Among the claims made by Viceroy was that Capitec was understating its uncollectible loan book to the extent of about R10 billion, and was 'curing' this by issuing new loans to delinquent borrowers. This was denied by Capitec and the South African Reserve Bank, which rushed to its defence.

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Viceroy Research is a 'hit squad,' Kganyago says

The Viceroy reports caused a 23% drop in Capitec's share price (from which it has more than recovered).

There has been some concern among analysts as to whether this fine, particularly the size of it, might have a chilling effect on research going forward.

Perhaps the more important question is: can two analysts look at the same data and come to entirely different conclusions?

Consider the case of Marvin Rothman, who predicted (correctly) that Donald Trump's Taj Mahal casino in New Jersey would fail. Rothman was fired after his boss received a letter from Trump with a demand to apologise or argue it in court.

Or the case of Investec analyst Anthony Geard who called on former Tongaat CEO Peter Staude to resign because of the company's 'appalling' financial results.

Investec issued an apology for causing any embarrassment to Staude, "with whom we have a long and fruitful relationship …" Tongaat was later found to have fudged its financial statements and Staude eventually did take the advice offered by Geard.

Steinhoff

Or consider the dozens of analysts issuing glowing recommendations on Steinhoff, weeks before it imploded in a fireball of financial fraud.

Ironically, Viceroy got this call right. The web of intricate transactions underlying the business, when aggregated, spelt trouble to the analysts at Viceroy.

There were a few analysts and fund managers in SA that were uncomfortable with Steinhoff, among them Adrian Saville, then at Cannon Asset Managers, who sold out of the stock on the grounds that it could not easily be understood, and this at a time when Steinhoff shares were on a rampage.

Shorting

Short sellers are regarded with suspicion by CEOs, because of the potential to hurt the value of company stock (and their own net worth).

Liberty founder Donald Gordon was known to rail against scrip lending when it was used to support short sales. "But the truth of the matter is that Liberty was losing direction and deserved to be downrated," says one fund manager.

Read: 'Shorting' in SA

"We definitely need more interrogative research that causes us to challenge our assumptions. If we had more of this kind of research, perhaps we would have been alerted to trouble at African Bank earlier than was the case," says Geoff Blount, investment director at TIP One fund.

"No one complains when analysts put out a strong buy signal, but you can certainly expect complaints when you put out a sell recommendation. There is a fine line here, where you don't want to be seen to manipulate the market, at the same time you want robust research that does not necessarily go along with the consensus," he adds.

Viceroy Research says it is appealing the FSCA fine which "seeks to shut down critical analysis of SA companies."

The US-based research firm says it met with and provided its working papers to the FSCA, which appear to have been ignored.

Announcing the fine last week, the FSCA was at pains to emphasise that the penalty was not intended to discourage research recommending a sell on SA stocks, only that the recommendation must be based on information that is not false, misleading and deceptive. And if research is based on misleading information, it must be corrected.

Viceroy replies that the FSCA's findings are predicated on Viceroy not publishing 'full and frank corrections' to its analysis, even after Capitec's open response to its questions. In other words, it continues to stand behind the research, which the FSCA found had benefitted a financial partner who had taken a short position in Capitec shares.

Market abuse

Section 81 of the Financial Markets Act deals with market abuse, and makes it clear that once the author of a report is made aware that it contains statements that are false, misleading or deceptive, a full and frank correction must be issued without delay.

Says Peter Major, director of mining at Mergence Corporate Solutions: "We all know how hedge funds work. They pump up a stock as much as possible, any way they can, before they short the hell out of it. And they do vice versa when they want to buy it."

Viceroy's response to the FSCA suggests it does not feel the need to issue a full and frank correction.

The obvious intention of the law is to prevent market manipulation under cover of research. But there may be times when two analysts presented with the same facts come to entirely different views of a company.

There is an element of self-censorship infused in much of the research issued on SA stocks, and has been for decades. If you want access to management, you had probably better remain within the consensus parameters.

As one fund manager told Moneyweb, when presented with a contrarian view by an analyst, one has to test the assumptions underpinning that view. And while the consensus view is safe, this too needs to be challenged. "It keeps us on our toes," he says.

High profile fund managers are often publicly bullish on shares they already hold in their portfolio, and are brazenly talking up their books while quietly selling into a rising market. Is that not market manipulation?

Whistleblower aspect

What about research based on whistleblower testimony that is not yet in the public domain? SA is rife with cases of whistleblowers being silenced with threats of legal action, notwithstanding the supposed armour of the Protected Disclosures Act.

Media outlets are often the last refuge for those with a dangerous story to tell. Whistleblower testimony may be wildly at odds with the official version, and may be wrong in aspects, but that should not prevent it from being tested, scrutinised and ventilated.

The penalties for launching SLAPP (strategic lawsuit against public participation) suits that are intended to intimidate and silence critics should be far more threatening than they are, and many countries now have some form of anti-SLAPP suit legislation in place. SA has yet to go down this road, and perhaps it should.

It remains to be seen whether Viceroy prevails in its appeal of the R50 million fine. Large fines issued by the FSCA against Steinhoff and Tongaat were later reduced – Steinhoff from R1.5 billion to R53 million, and Tongaat from R118 million to R20 million.

This was to spare shareholders having to take more pain than that already suffered. In October 2020, the FSCA hit former Steinhoff CEO Markus Jooste with a fine of R161 million for insider trading, after he notified three friends by SMS to sell their shares.

The broader question is what impact this will have on research going forward. That remains to be seen.

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FSCA fines Markus Jooste, three others around R241m