New disclosure system a plus

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The enacting of the Securities Markets and Institutions Bill coupled with the start of the revised NZSE listing rules this week has created quite a stir in the market. Media commentary has related mainly to a single aspect of the renamed Securities Markets Act 1988 (one of the three acts amended by the new bill) and the revised listing rules introducing a continuous disclosure regime for listed companies. I have found the reactions to the new regime surprising, especially the view that the market will suffer as a result.

What the reaction has revealed is the wide range of views on whether continuous disclosure is positive for investors or companies. The facts are straightforward. In this article we look at some of the arguments being made against continuous disclosure alongside the known benefits of such a regime.

Continuous disclosure is essential to ensure the growth, efficiency and integrity of our capital markets. In particular, it is a core contributor to the maintenance of fair, orderly and transparent markets. End of story. It is not in anyone's interest, least of all the NZSE's, to hinder companies' growth, deter them from listing, disadvantage investors or disfranchise analysts, as certain commentators have suggested continuous disclosure will surely do. In order for New Zealand to grow, capital markets must grow. It is the NZSE's job to help that growth. It would be bizarre for the exchange to introduce measures that defeat its mandate, and I am astounded that people consider the NZSE has done exactly that.

Each of us should be concerned to ensure that the regulatory environment in which our capital markets operate reflects best practice and that the market is well regulated and fair. In order for New Zealand's capital markets to grow and survive in a globally competitive environment, we must attract foreign investment and retail capital.

Investors are drawn to markets which are conducted with fairness. Equally, markets need to operate with integrity to maintain the confidence of retail investors. It is beyond question that some of the key principles to encourage a well-run market and enhance investor confidence include:

* Equitable and fair treatment of security holders.
* Full, timely and accurate disclosure of information, ie informed investors. * Effective investigation, surveillance and enforcement powers.
* Detection and deterrence of unfair trading practices.
* Strong sanctions for companies which breach the rules.

When the continuous disclosure regime is stacked up against these principles, it is evident that it plays a fundamental role in giving investors confidence, thereby building liquidity and depth in our market. Continuous disclosure means the market is informed at all times and no investor is disadvantaged by lack of access to material information. The disclosure requirements also encourage informed decision-making by all parties.

The NZSE's proximity to the market is essential to flexible and responsive monitoring and application of the continuous disclosure framework. This is strengthened by the Securities Commission's legislative, investigation and enforcement powers, the deterrent impact of which produces a market of high integrity and efficiency based on timely disclosure of information. So let us look at some of the arguments put forward in the last week or so by commentators saying continuous disclosure does not provide the benefits the NZSE claims.

The first argument is that companies will lose competitive advantage as a consequence of the regime. In my opinion, this argument is ill-founded and potentially confusing for investors. Under the disclosure regime that prevailed before December 1, a company engaged in a due diligence exercise (such as an acquisition), for example, was required to apply for a waiver from the disclosure listing rules.

Where a waiver was granted, it was on condition that those due diligence discussions stayed confidential and the Market Surveillance Panel approved the terms of the confidentiality arrangements.

Under the new regime, provided confidentiality is maintained during the course of the due diligence, an issuer in the same circumstances does not have to seek a waiver from disclosing this information, as the rule itself recognises and accommodates such discussions.

Thus the rules are more flexible and recognise commercial realities and reduce compliance costs for issuers. As an ancillary point, companies listing on the NZSE need to understand that one of the responsibilities of being listed is to ensure they do not withhold material information that is not generally available to the market from the companies' owners - ie, the shareholders. (Material information is information that would have a material effect on the price or value of the issuer's securities, if that information were known.)

This goes to the heart of the "risk and return" issue. There are many benefits to be gained by listing - increased access to capital, increased profile and credibility, to name but a few. These benefits need to be balanced against the responsibilities of shared ownership. If companies are unwilling to accept these responsibilities, they should not list.

The second criticism is that the requirement to release information on adjusted forecasts immediately is bad for the market generally. The reality is that listed companies from time to time do lose money, might not meet their forecasts and may face asset write-downs. The market reacts to these losses. Whether the market is advised immediately or at an interim reporting period, it will react to a company not meeting expectations. In other words, the market reacts to the content of the news it receives; its reaction is not dependent on when it receives it. Why should the owners of that company have to wait to be told of the financial position of the company if management knows it is not as rosy as the market expects? Should investors really be expected to continue to invest on the basis of expectations that are not accurate? How can having information on which to base their investment decisions be perceived as bad for investors? The owners of all businesses in New Zealand - whether public or private - must take responsibility for their companies' actions and business decisions.

The suggestion that information is bad for investors implies that investors cannot filter information about companies they may invest in without panicking, that they will react immediately based on the information without absorbing it or considering other factors. It implies that all investors are inexperienced, which is simply not true of the New Zealand market. I believe that we have a wealth of astute investors who understand the need for a steady flow of information - even the more inexperienced investors get the basic idea of this.

In summary, the goal of the NZSE and other securities regulators is to foster growth and develop a strong market infrastructure - primarily to attract more companies and more investors to the marketplace. Better regulation makes the market fairer for all.

The NZSE sees that continuous disclosure will contribute to this by:
* Promoting capital market efficiency by ensuring equity resources are more effectively channelled into appropriate investments and funds are withheld or withdrawn from poorly disclosing entities.
* Overcoming the inability of the market to ensure adequate and timely disclosure.
* Encouraging greater research to ensure prices more closely reflects underlying economic value.
* Enabling better assessment of investment alternatives to equity and debt holders.
* Lessening the distorting effect of rumour on price.
* Minimising opportunity for insider trading and similar abuse. * Improving managerial performance and accountability by providing more timely indicators of corporate performance.
* Enhancing investor confidence by increasing transparency.

Who wants to invest in a company when they are not assured of access to all information? My guess is very few people. That's why the NZSE stands by its new rules. And we believe that all listed companies will see the benefit through increased shareholder confidence and greater liquidity.

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