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## Plenary 1

Increasing Disclosure – A Key to Improving  
Investor Confidence

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# **IOSCO ANNUAL CONFERENCE**

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## **Panel 1**

### **“Increasing disclosure – A key to improving investor confidence”**

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- The disclosure of information has an impact on supply and demand schedules and their interaction to determine the equilibrium price. Under these circumstances, fair and efficient financial markets rely on timely and homogeneous information flows. In particular, it is important that information is conveyed to financial market participants, at the appropriate time and in the appropriate manner, in order to reduce information asymmetries and to allow market participants to take investment decisions on the basis of an as complete as possible set of information.
- The widespread availability of information in financial markets can be analysed under two main perspectives:
  - a) the disclosure of information on issuers and their listed securities;
  - b) the transparency of information relating to the trading activity observed in the market.
- The disclosure of information concerning issuers and their listed securities has been developed on the issuer obligation to convey to the market the information considered price sensitive. In other words, the issuer itself has been considered the key source of information.
- Under the transparency perspective, the monopoly of stock exchanges has made them the key and unique source of pre and post-trade information. In other words, the presence of a monopolistic pool of liquidity has led market participants, and regulators in their regulatory activity, to focus their attention to the information made available by stock exchanges.
- The world is changing and new sources of information arise affecting both the area of the dissemination of price sensitive information and the transparency of secondary markets.

- ***Issuers and stock exchanges are no more the only source of information. Moreover, issuers, stock exchange and regulators may not have the direct control on the information disclosed by the new price sensitive information sources.*** The IOSCO Objectives and Principles state:
  - under the Section on “Principles for Issuers”, Principle n.14 states that “*there should be full, timely and accurate disclosure of financial results and other information that is material to investors’ decision*”;
  - under the Section on “Principles for the Secondary Markets”, Principle n. 27 states that “*regulation should promote transparency of trading*”.
- There is a cross-border interest in this new scenario in that information goes globally instantaneously and can trigger effects in many linked financial instruments/markets. It is therefore important for regulators to keep pace with what needs to be disclosed, how it is disclosed and how oversight responsibility is structured and implemented.

#### **A. Issuers**

- In all jurisdictions, listed issuers are subject to an extensive and mature regulation in which specific requirements for the timely notification and dissemination of material information have to be fulfilled.
- Nevertheless, new elements enter in the analysis of the adequate amount and accuracy of the price sensitive information conveyed to market participants. Among the others, it seems interesting to examine the issues related to: i) the increasing role of new sources of price sensitive information (i.e. market sources and the so-called “secondary sources”); and ii) issuers that are simultaneously a source of material information and actors in the market (i.e. Stock Repurchase Programmes (SRPs) and Insider Dealing).

**(i) *Other information sources***<sup>1</sup>. Other information sources, not directly related to issuers’ information disclosing activity, have gained in importance and have the potential to affect the value of stock prices and/or trading volumes. These might include:

- a) *Market sources* (such as government and other official sources of information, data and statistics published by public institutions disseminating statistics, central banks decision concerning interest rates, government’s decision concerning taxation and

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<sup>1</sup> Although other sources represent crucial topics on which there is a strong debate, they are not specifically addressed in this presentation.

industry regulation, market operators' decision concerning rules governing markets, competitor of target listed issuer); and

- b) the so-called “*secondary sources*” of information, which include a wide range of entities gathering public primary information and subsequently disseminate them previously revised or summarised (analysts, rating agencies, journalists, news wires, news portals, Internet and Finance portals).

The recent principles on financial analysts and credit rating agencies prove the importance of such information sources.

(ii) ***Stock Repurchase Programme and Insider Dealing***. Stock Repurchase programmes (SRPs) are becoming an increasingly common practice world-wide and, in recent years, they have proved a significant factor in the relatively slow growth in net outstanding equity, in subsequent earnings per share growth, and in rising share prices. Stock Repurchase Programme<sup>2</sup> and Insider Dealing are becoming areas in which transparency may play a crucial role. In relation to these events, concerns arise because issuers, including its relevant shareholders or top management, may simultaneously be source of price sensitive information and actors in the market through transactions that, providing liquidity, could affect market prices.

SRPs are a potential source of market risk, since the knowledge of the decision to carry out an SRP and the related transactions may be considered price sensitive information. Moreover, such operations could, under certain circumstances, undermine market integrity where SRP transactions are undertaken with the particular purpose of affecting the market price of the [related] securities or the entity undertakes the SRP to make use of its own material, non-public information<sup>3</sup>.

Furthermore transparency of transactions conducted by persons discharging managerial responsibilities within issuers and, where applicable, persons closely associated with them, on the one hand constitutes a preventive measure against market abuse, on the other hand, can also be a highly valuable source of information to investors.

## **B. Trading Venues**

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<sup>2</sup> Companies engage in SRPs for many different reasons and, depending on national laws, they can use a number of mechanisms to repurchase their own securities.

<sup>3</sup> In case of SRPs, the risk of market abuse practises refers to two main situations: i) managers are inside shareholders and, on the other hand, ii) the company itself purchases its own shares. Lack of disclosure about SRP transactions carried out by the company in the market can create situations in which conflict of interests between inside and outside shareholders could arise. For example, shareholders/managers may sell their shares taking advantage of a known price pressure determined by transactions carried out by the issuer, where the public at large is not aware of SRPs transactions.

- The competition in the provision of trade execution services determines a fragmentation of information. Moreover, stock exchanges do not control all the relevant information related to securities trading in financial markets and new sources of information may refer to entities that are not regulated in their information disclosing activity.
- The issue of transparency relating to current opportunities to trade and recently completed trades has been object of a strong debate under the proposal for a revised Investment Services Directive (ISD) by the European Commission.
- Market transparency, as the widespread availability of information relating to current opportunities to trade and recently completed trades, is generally regarded as central to both the fairness and efficiency of a market, and in particular to its liquidity and quality of price-formation.
- In a fully centralized market, there is a single set of transparency arrangements and the consolidation of relevant trading information should be straightforward. When competing trading venues emerge, that situation is likely to change. While competition among providers of trade execution services may improve a market's efficiency, it may, in some circumstances, have a detrimental effect. This would be the case where, for instance, competition results in fragmentation that may lead to: (a) significantly different transparency levels across the market and/or excessively high search costs for market participants and investors, (b) investor protection concerns concerning the scope for conflicts of interest within broker-dealers which may execute client orders internally against proprietary trading positions (internalisation), and (c) undermine the representativeness of on-exchange prices, which have traditionally served as an anchor for best execution policies, and make very difficult for investors and their brokers to have access to the best available trading opportunities and to verify if investment firms have discharged their duties to a client.
- It is a common view that a high level of transparency is a hall-mark of an efficient market and that is the best safeguards for investors interests. Although the importance of transparency to overall market efficiency and fairness is widely recognised, establishing market transparency standards is not straightforward: the interest of individual market participants and their customers in transparency levels varies<sup>4</sup> and while competition among providers of trade execution services may improve a market's efficiency, it may, in some circumstances, have a detrimental effect.<sup>5</sup>

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<sup>4</sup> IOSCO TC Report on "Transparency and Market Fragmentation" (November 2001).

<sup>5</sup> The IOSCO TC also published a Report on "Transparency and Market Fragmentation".

- However, the level of transparency in secondary markets, as a mean to improve investor confidence, is not confined to pre and post-trade information. I would like to focus more on issues related to information on securities trading which may or may not be under the direct control of stock exchanges and which have been recently considered by the IOSCO SC2. In particular:

***a) Indexation and information on index rebalancing rules and methodologies<sup>6</sup>***

From a market perspective, index rebalancing processes represent a source of price sensitive information. In fact, the identification of stock to be added to/removed from an index often results in price volatility and high turnover in those stocks around the time of rebalancing. Given the potential and observed short-term impact on the share price and trading volume, this is another area in which transparency plays a crucial role.

It is important that information on the rebalancing rules and methodologies adopted by index providers, as well as details on proposed index revisions, are available on as wide and timely basis as possible. However, it is often the case that index providers are not entities whose activities are under the direct supervision of regulators.

***b) Trading halts and information on current possibilities to trade<sup>7</sup>***

The application of trading halts in circumstances in which a security (or derivative on that security) is traded in more than one trading venues located in different jurisdictions raises a number of issues for market regulators, market operators and market participants<sup>8</sup>. These include the efficiency of the processes by which information relating to a trading halt imposed in one market may be transmitted to, or accessed by, other relevant trading venues and their users, and the potential risks to investors and/or market users arising from different approaches to trading halts.

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<sup>6</sup> IOSCO TC Report on “Indexation: Securities Indices and Index Derivatives” (February 2003).

<sup>7</sup> IOSCO TC Report on “Trading Halts and Market Closures” (October 2002).

<sup>8</sup> Concerns about transparency and regulatory arbitrage are less pronounced with regard to a halt in the trading of a security that is listed in more than one market, but only within a single jurisdiction.

Communication between issuers, market venues, and regulators within one jurisdiction should be relatively straightforward and there is limited potential for regulatory arbitrage in a single jurisdiction. Where the venues are located in different jurisdictions, the issues are of potentially greater complexity: not only is there a greater likelihood of differences in the application of trading halts, but the processes involved in establishing and maintaining cross-border information flows are likely to be more demanding.

Lack of transparency with respect to trading halts poses risks, whose significance is greater in cases where trading interruptions have been called to allow market absorption of new material information in respect of an issuer<sup>9</sup>.

c) ***Short selling and information concerning specific trading activities that lead securities to be over-valued.***<sup>10</sup>

The SC2 has recently examined the role that greater transparency of short selling might play in securities markets and the forms such transparency might take<sup>11</sup>. It is common view that there is value in the disclosure of short selling to market users and in the provision of transparency in short selling regimes<sup>12</sup>. At the same time, there are counter-arguments that consider that excessive transparency may deter short sellers, thus detracting from, not enhancing, efficiency and the ambiguity of the information disclosed may mislead, not assist market users.

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- In conclusion, ***the increased number and importance of new sources of information has determined a fragmentation of information in which:***
  - ***traditional “information providers” (issuers and stock exchanges) do not represent the unique source of information;***
  - ***issuers and stock exchanges may not have a direct control on the information disclosed by the new sources;***

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<sup>9</sup> In particular: (a) investors using parallel markets exposed to higher risk if, during a suspension in a primary market, they executed their orders by making use of a trading facility that remained open; (b) investors in other jurisdiction may not be aware that there has been a trading halt ahead a significant announcement; and (c) the ability of some investors to switch their trading might undermine the effectiveness of such a measure.

<sup>10</sup> IOSCO TC Report on “Transparency of Short Selling” (June 2003).

<sup>11</sup> In some cases, disclosure involves publishing cumulative short sales volumes in individual securities on a daily basis; in others, it involves periodic publication of the overall short position in individual securities as measured at a specific moment.

<sup>12</sup> As underlined in the IOSCO Report on “Transparency of Short selling” (2003), the benefits of a transparency regime may be identified in:

- Timely information on short selling would provide market users with an early signal that there may be material grounds for considering individual securities to be over-valued;
- The removal of uncertainty as to how much selling in a share was short or long selling might improve investors’ willingness to trade. This is particularly important given the adverse impact that rumours of short selling can sometimes have on trading;
- Probably less contestable, information that sales are short creates an awareness that, at some future point, those sales will need to be reversed by new purchases;
- Greater transparency would tend to deter attempts at market manipulation.

- *new sources of information may refer to non-supervised entities.*

- In this new environment, the issue is to investigate whether a sufficient and accurate flow of information to the market is still ensured and, if it is not the case, the measures and necessary steps to be taken into account to respond to the new challenges posed by the fragmentation of information. In particular:

1. *the measures available to regulators to ensure a high quality of information;*
2. *what is in the issuers' responsibility; and*
3. *what is in the stock exchanges' responsibility*

### **1. Where regulators stand**

- Regulators have a general responsibility on the “quality” of information disclosed and conduct a continuous market surveillance activity in this area. Regulators usually support higher transparency and disclosure of information because, in general terms, markets rarely suffer from greater levels of both of them.
- The fragmentation of information assigns greater responsibilities to regulators as to the measures they should consider to ensure a high quality of the information disclosed to the market. In this respect, regulators need to take into account:
  - a) cost and benefits arising from any transparency regime: factors to be carefully considered are the costs related to new information dissemination arrangements, potential negative effects on markets arising from costs for issuers and intermediaries related to additional transparency/disclosure requirements, and the risk for regulatory arbitrage;
  - b) the legal and regulatory structure as well as the market characteristics and the local environment, to which any transparency regime should be tailored;
  - c) the regulatory framework adopted in other jurisdictions, in order to minimize the risk of regulatory arbitrage;
  - d) the whole set of information sources in their market surveillance activity in order to ensure the orderly conduct of trading.
- The number and nature of the additional sources of information certainly make it more difficult for regulators to identify ex-ante the proper transparency regime. In this respect, it is essential that the synergies between the market regulation and the market surveillance



activities are enhanced so that any transparency regime is the result of an interactive process in which regulators carefully and continuously monitor the impact of the rules on market conditions.

- In any event, regulators should be in the position of ensuring a sufficient and accurate flow of information to the market through either stricter surveillance or/and new ad-hoc regulation.
- In other words, where the new sources of information entails the activity of non-supervised entities and a high level of transparency cannot be ensured, regulators should be able to react with a stricter market surveillance.

## 2. **What is in the issuers' responsibility**

- Listed companies have a responsibility on the accuracy of the information released in the market by themselves. It should be in the issuer interest to take care of the accuracy of the information on its activity and listed securities provided by other sources of information.
- In presence of multiple trading venues the issuer may not be asked to monitor the trading activity on its securities in all the market places on which they have been admitted to trading. However, issuers' responsibility cannot be confined to the material information they disclose.
- Where information other than those disseminated by the issuer determine substantial changes in the price or quantities of securities traded in the markets in which the issuer has been asked to be admitted to listing, the issuer itself needs to verify the truthfulness of the news and correct them where necessary in order to restore conditions of correct information.
- This would be the case where: a) rumours have been disseminated to the market (the accuracy of the information conveyed to the market strictly depends on issuers' responsibility to comment such rumours<sup>13</sup>); b) third entities provide forecasts disclosed to the market: the issuer should take the necessary steps to comment them where they prove to be inaccurate;
- In the new environment described above, issuers continue to represent a primary source of information on which investors rely for their investment decisions. In this respect, the

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<sup>13</sup> If in the presence of rumours the market price of financial instruments varies significantly or there are details contained in the rumour that suggest a breach of confidence has occurred and the matter is price sensitive the issuer should make an announcement. For example, in Italy a provision set in Consob Regulation explicitly requires issuers to promptly inform the public as to the truthfulness of such news (where the price of the financial instrument on the market on which they are admitted to trading at their request varies significantly compared with the previous day's official price) and supplement or correct it where necessary in order to restore conditions of correct information.

issuer's trading activity carried out on their own shares represent an important signal conveyed to the market. Moreover, since the implementation of an SRP is a source of material information which is likely to have an impact on the price of listed repurchased shares, the decision to carry out an SRP poses issues concerning the disclosure to the public of relevant information during all the phases of an SRP. In this respect, a disclosure regime represent a valuable tool (for regulators as well as market participants) to monitor issuers behaviours and to verify the reliability of the signals conveyed to the market<sup>14</sup>.

- It is also important to know the behaviour of controlling shareholders and top management about transactions conducted on the market in their own account relating to shares of the relevant issuer... This is also more valid for their, especially in relation to possible contextual SRP (if they buy and sell in connection with the program). This is also essential to permit to market participants to evaluate ex-post the behaviour of the issuer and of top management.

### 3. What is in the stock exchanges' responsibility

- Stock exchanges have a general responsibility on the “quality” of information disclosed on the market they operate and conduct a continuous market surveillance activity in this area. However, the topics discussed above provide examples of areas in which stock exchanges may not have direct control on the information sources and the entities providing them.
- Market operators should start thinking themselves as “active” entities with:
  - (i) a responsibility on the level and accuracy of the trading information provided, even where the information is produced by third not supervised entities (index rebalancing). A crucial role is played by market operators, which should promote the timely disclosure to the public of the relevant information collected from index providers. Moreover, market operators should promote the establishment of information sharing mechanisms with index providers and react to any lack of disclosure arrangements by enhancing their market surveillance activity<sup>15</sup>;
  - (ii) a duty to cooperate and establish information sharing mechanisms with other trading venues in order to ensure the effectiveness of the regulatory measures and orderly

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<sup>14</sup> Managers are not bound by the announcement of an SRP as there are not firm commitments to implement such repurchases programmes. In this respect, SRPs may represent a potential source of dissemination of false or misleading information when managers disclose to the public the intention to carry out an SRPs, investors rely on such announcement looking forward to the implementation of the repurchase and the SRP will not take place or it is going to be interrupted.

<sup>15</sup> Some jurisdictions (such as Italy and Hong Kong) have provided the market with information on the potential impact on securities trading volume and market volatility as a part of the MSCI rebalancing on November 30, 2001 through a Press Release.

markets (trading halts). Transparency and public availability of information concerning the decision of a market to interrupt trading is crucial to ensure the orderly conduct of trading. However, the effectiveness of such regulatory measure is also strictly dependent on market operators' willingness to establish information sharing and cooperation arrangements in order to avoid the risk of regulatory arbitrage in situations in which a security halted in one market continue to be traded in others. In circumstances in which neither the issuer nor the listing market are aware of all the trading platforms on which an issuer's security is traded, the operator of a trading facility should endorse an active role in order to ensure that market users have timely access to information relating to trading halts imposed in the primary market;

(iii) a duty to carefully monitor market conditions and the information produced by market participants through their trading activity (short selling), in order to check the adequacy of any transparency regime to the local market environment. The impact of short selling activity varies among markets because of the local market characteristics and the various reasons behind the decision to sell short. Although short sales contain information that may be of value to both regulators and market users, the information message from a short sale may be ambiguous, and possibly open to various interpretations due to the various reasons behind the decision to sell short. In this respect, market operators should (a) enhance their market surveillance activity to understand the nature of the short selling activity in their local markets and the impact that any short selling transparency regime have on trading activity; and (b) strictly monitor the quality of the data disclosed under the transparency regime in order to avoid any detrimental effects it may have.

## Conclusions

- The world is changing and the new sources of information have gained in importance, for the impact they have on stock prices and trading volumes, affecting both the area of dissemination of prices sensitive information and the transparency on secondary markets.
- The increased number and importance of new sources of information has determined a **fragmentation of information** in which:
  - *traditional "information providers" (issuers and stock exchanges) do not represent the unique source of information;*
  - *issuers, stock exchanges and regulators may not have a direct control on the information disclosed by the new sources;*
  - *new sources of information may refer to non-supervised entities*

- The role and responsibilities of regulators increase as well as the difficulties they face in order to ensure a sufficient and accurate flow of information to the market through stricter surveillance and new ad-hoc regulation.
- It is essential that the *synergies between the market regulation and the market surveillance activities are enhanced so that any transparency regime is the result of an interactive process in which regulators carefully and continuously monitor the impact of the rules on market conditions.*
- Although issuers and stock exchanges cannot be considered responsible for the information coming from a myriad of sources, they should endorse an active role with respect to trading conditions and price impact of the information disclosed and promptly react where needed.
- Issuers' responsibility cannot be confined to the material information they disclose. Where *information other than those disseminated by the issuer determine substantial changes in the price or quantities of securities traded in the markets in which the issuer has been asked to be admitted to listing, the issuer itself need to verify the truthfulness of the news and correct them where necessary in order to restore conditions of correct information.*
- Stock exchanges should start thinking themselves as “active” entities:
  - *They have a responsibility on the level and accuracy of the trading information provided*, even where the information is produced by third not supervised entities (index rebalancing);
  - They have a *duty to cooperate and establish information sharing mechanisms* with other trading venues in order to ensure the effectiveness of the regulatory measures and orderly markets (trading halts);
  - They have a *duty to carefully monitor market conditions and the information produced* by market participants through their trading activity (short selling), in order to check the adequacy of any transparency regime to the local market environment.
  - In any event, *any lack on the above measures and arrangements should be counterbalanced with a stricter market surveillance* by stock exchanges.

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- *Transparency represents a core characteristic of financial markets: it permits, ex ante, to take investment decisions and, ex post, to evaluate the quality of the market. We have to encourage greater levels of transparency but we have also to monitor the impact that any transparency regime has on the market in order to constantly verify its adequacy.*