Foreword

This book is particularly timely as it is important at this stage in the evolution of our global financial markets. It is a masterful comparative analysis of disclosure laws and practices in a broad range of jurisdictions including the United States, Canada, Germany, UK, Japan, Hong Kong, Australia and Singapore. The legal analysis of each jurisdiction's rules is supported by the case studies of the disclosure practices of two leading corporations in each jurisdiction.

The groundwork for this extensive comparative analysis is laid in the first four chapters which examine the theory of mandatory corporate disclosure regimes, their impact on insider trading, and the prevalence of selective disclosure to certain analysts and other privileged parties at the expense of the general public.

The eight comparative chapters form the core of the book. After them, the work concludes with three substantial chapters which examine and pull together conclusions about periodic and continuous disclosure regulation and practice, and then develops a best practice disclosure framework. The author concludes with a strong endorsement for the rules and practices of the Securities and Exchange Commission in the US and American approaches to disclosure generally.

To write a work of this depth and rigor requires a certain fire in the belly. In this author's case, the fire appears to have been stoked by long years as an asset manager and financial analyst in some of the principal global financial centres. The practice of selective disclosure is widespread with corporations conducting briefings for privileged analysts and others. It is a practice that has galled this author and provided the impetus for this major contribution to the literature. We have, regrettably, moved a long way from the guiding ethos of the 1930s US reforms which was that, in Louis Brandeis' words, 'sunlight is the best disinfectant'.

I, for one, hope this author turns her considerable forensic and analytical capacities to the next most pressing issues in global disclosure which, to my mind at least, include the rapid rise in the past decade of algorithmic high frequency trading and 'dark pools'. A high proportion of the orders placed in high frequency trading are, apparently, placed to mislead other investors or, at the least, obfuscate which trades are actually being implemented; and dark pools involve removing trades from the lit exchange during the trading day thereby placing participants on the lit exchange at an

informational disadvantage. Both of these developments, therefore, represent further significant departures from transparency in our markets in my view. Appropriately neither have been addressed in this book as this is a global analysis of disclosure regimes and high frequency trading and dark pools are therefore rightly beyond its purview. However, both topics would benefit if the forensic and analytical excellence on display here were brought to bear on them.

Disclosure has come under sustained criticism as an organising regulatory principle in recent years in light of its apparent failure to prevent the crisis of 2008. Many have questioned whether disclosure is an adequate approach to the increasing complexity and opacity of many modern financial products. I have argued elsewhere that the problem lies not in the disclosure regimes, but in the complexity and opacity of the products. While continued criticism and analysis is always to be encouraged in our system, to criticise disclosure as an organising principle in the absence of something better does not seem particularly productive. It is possible that the calls by some regulators for the power to ban certain products outright may be the right way to go, but certainly I, for one, doubt the capacity of any regulator to consistently get those sorts of judgment calls right over the longer term.

Associate Professor Gill North clearly has not given up on disclosure as the organising principle for our markets. Instead she has written a clarion call for us collectively to turn our backs on selective disclosure and support to the fullest extent possible clear, transparent and uniform disclosure across the markets. This is a call, contained in a book, that I heartily endorse.

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List of Abbreviations

AASB	Australian Accounting Standards Board
ADR	American Depositary Receipt
AIM	Alternative Investment Market
AIMR	Association for Investment Management and Research
AIRA	Australian Investor Relations Association
ASIC	Australian Securities and Investment Commission
ASX	Australian Securities Exchange
ASXSR	ASX Supervisory Review Pty Limited
BHP	BHP Billiton Limited
BP	BP Plc
CBA	Commonwealth Bank of Australia Limited
CEO	Chief Executive Officer
CFO	Chief Financial Officer
China Mobile	China Mobile Limited
CICA	Canadian Institute of Chartered Accountants
Citigroup	Citigroup Inc
Compliance Department	Listed Company Compliance Department
CRR	Corporate Responsibility Reporting
CSA	Canadian Securities Administrators
CSR	Corporate Social Responsibility
Deutsche Bank	Deutsche Bank AG
DTR	Disclosure Rules and Transparency Rules
EBIT	Earnings before Interest and Tax

entirely credible because participant behaviour is often, sometimes even predictably, irrational.[2]

It is important for readers to understand the role, nature and limitations of individual scholarly models and theories. Theoretical assumptions are not intended to fully reflect real world complexities. A theory is by necessity based on abstraction. Nonetheless, an 'important test of a theory is its ability to explain reality.'[3] Bridging the gap between theory and reality sometimes requires the use of extrapolation and human judgment for the theory to have practical application.[4] Theoretical frameworks that are narrowly constructed can present difficulties for policy makers, who determine company disclosure and insider trading rules, and for judiciaries, who are required to interpret this regulation. To be effective, company disclosure and insider trading regulation must take into account the fact that financial markets are controlled largely by human participants and that we do not always act entirely rationally or within the law, particularly within financial spheres when there are large potential monetary gains involved.

2. See, e.g., John Keynes, *The General Theory of Employment, Interest and Money* ((Macmillan, London, 1936) 156.
3. Richard Posner, *Economic Analysis of Law* (Aspen, 6th ed., 2003) 17. See also Karl L Popper, *The Logic of Scientific Discovery* (Hutchinson, 1959) 59. Popper argues that a 'theory' is a net 'cast to catch … "the world"; to rationalize, to explain, and to master it.'
4. John McMillan, 'Market Design: The Policy Uses of Theory' (2003) 93 *American Economic Review* 139, 143.

CHAPTER 2
Mandatory Corporate Disclosure*

> Our era aptly has been styled, and well may be remembered as, the 'age of information.' Francis Bacon recognized nearly 400 years ago that 'knowledge is power,' but only in the last generation has it risen to the equivalent of the coin of the realm. Nowhere is this commodity more valuable or volatile than in the world of high finance, where facts are worth fortunes while secrets may be rendered worthless once revealed.[1]

§2.01 OVERVIEW

Most developed nations have established listed company disclosure frameworks that encompass periodic reporting and some form of disclosure between reporting periods.[2] Nevertheless, scholarly debates concerning the need for, and justification of, disclosure regulation continue. One legal commentator concludes that '[p]roponents of the third-party externality rationale have not specified what information requirements the rationale justifies, let alone whether that information is the focus of … disclosure requirements.'[3] Some accounting and economics academics suggest that 'it is surprising how little we still know about fundamental issues such as the reasons for disclosure regulation in developed markets and the determinants of the format of this regulation …[and] the objectives of managers in making voluntary disclosures.'[4] Company

* Some of the material discussed in this chapter is contained in a published article: Gill North, 'Timely Public Disclosure of Company Information: A Likely Precondition for Optimal Long-Term Corporate and National Outcomes' (2014) 32 *Company and Securities Law Journal* 560.

1. *SEC v. Materia*, 745 F.2d 197, 198 (2d Cir. 1984).
2. Companies are typically required to provide specified information to the market under periodic reporting and continuous disclosure regulation. In addition, failures to provide mandated information, selective disclosure, or misleading disclosure may be governed by insider trading, selective disclosure, market abuse, or misleading and deceptive conduct regulation.
3. Roberta Romano, 'Empowering Investors: A Market Approach to Securities Regulation' (1998) 107 *Yale Law Journal* 2359, 2380. An 'externality' is an uncompensated cost or benefit that may be intentional, accidental, or incidental.
4. Anne Beyer, Daniel Cohen, Thomas Lys and Beverly Walther, 'The Financial Reporting Environment: Review of the Recent Literature' (2010) 50 *Journal of Accounting and Economics* 296, 336.

managers and advisers often claim such regulation is burdensome, too prescriptive and costly.[5] Others argue that disclosure is a limited tool and it is time for the main debate to shift to fresh policy options.[6] The Kay Review of UK Equity Markets (Kay Review) even suggested that '[d]isclosure and transparency have become mantras in policy and in regulation.'[7] These views reflect the highly political nature of company disclosure law and the varying perspectives and incentives of the groups involved. The disclosure debates will undoubtedly remain robust and contentious given the power imbalances and high monetary stakes involved.

A major weakness in the existing literature is the lack of an overarching theory, making it difficult to capture and assess existing and potential disclosure models and arguments. It is notoriously difficult to develop a theoretical structure that comprehensively encompasses financial market and corporate environments, given the interdependencies or endogenous nature of the variables and drivers involved. There are distinct differences across the disclosure literature between contributors' assumed financial market and company disclosure environments, and many of the efficiency and fairness notions are imprecise or ambiguous. Commentators tend to emphasise models or definitions from a particular discipline, such as economics, accounting, finance or law, and the adopted research methodologies and assumptions can vary markedly. This chapter acknowledges the many difficulties and complexities that arise when discussing theoretical and empirical issues regarding corporate disclosure. Nonetheless, it concludes that company periodic and continuous disclosure regimes are likely to deliver better investor protection, more efficient, fair and transparent financial markets, lower systemic risk, and superior long-term corporate, economic and community outcomes, compared to those achieved in voluntary disclosure environments. It suggests that public disclosure frameworks in the twenty-first century should be wholeheartedly accepted as being in the long-term interests of listed corporations, and the communities and countries in which they operate. The arguments advanced for mandatory disclosure regimes are outlined in this chapter in three ways. First, the chapter responds to arguments that are generally accepted as the rationales for opposing company disclosure regulation. Second, it highlights the critical interconnections between financial market incentives, efficiency, fairness, and governance factors. Third, it outlines interdisciplinary empirical research that suggests that there are significant associations between high quality company disclosure in financial markets and superior long-term corporate, economic and community outcomes.[8]

5. See, e.g., European Commission, Report from the Commission Staff Working Paper *Impact Assessment* (SEC(2011) 1280 final) 13.
6. See, e.g., *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) 72.
7. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) 70. See Gill North, 'Listed Company Disclosure and Financial Market Transparency: Is this a Battle Worth Fighting or Merely Policy and Regulatory Mantra?' (2014) 6 *Journal of Business Law* 484.
8. The definitions of variables and outcomes within individual scholarly empirical studies vary. These definitions are generally defined in the studies.

Global events and developments over the last decade clearly highlight the interconnections and alignments between corporations, real economies, and communities. Country-specific and global empirical studies of financial markets consistently link improved corporate and national outcomes to high disclosure standards, vigorous enforcement of securities laws, broad investor participation, protection of minority shareholder rights, and public trust. Growing bodies of empirical research also suggest there are associations between mandatory disclosure frameworks and sound corporate governance and corporate sustainability practices. This combined research suggests that the mandatory disclosure theoretical debates should not be characterised as simply a 'turf war' between different classes of shareholders. Instead, it points to compelling commercial and societal imperatives for comprehensive regulatory frameworks governing listed company communication in financial markets.

The debates concerning mandatory disclosure regimes have been running strongly for many decades. The literature on mandatory disclosure generally focuses on two essential questions; first, whether the information provided in a voluntary company disclosure environment is sufficient, and second, the appropriate nature and scope of the disclosure regulation.[9] The main issues discussed in the interdisciplinary theoretical debates concern the incentives companies have to disclose information to the market, and the relative efficiency and fairness of voluntary and mandatory disclosure regimes.[10]

§2.02 INFORMATION INCENTIVES

The discussion concerning company disclosure begins with the lifeblood of all modern developed financial markets – information. Scholars agree that the efficient operation of financial markets requires the disclosure of timely and accurate information. Views differ, however, on the expected quantity and quality of information provided in discretionary disclosure environments in the absence of disclosure regulation.

[A] The Information Conundrum

General information can operate as a public or private good, or it may have a dual character and be produced and used in both spheres.[11] Within the public sphere, information is viewed as a resource to be shared and spread as widely as possible, and

9. See, e.g., John Coffee Jr, 'Market Failure and the Economic Case for a Mandatory Disclosure System' (1984) 70 *Virginia Law Review* 717, 722, 725–737; Merritt Fox, 'Required Disclosure and Corporate Governance' (1996) 62 *Law and Contemporary Problems* 113; Merritt Fox, 'The Issuer Choice Debate' (2001) 2 *Theoretical Inquiries in Law* 563; James Cox, 'Premises for Reforming the Regulation of Securities Offerings: An Essay' (2000) 63 *Law and Contemporary Problems* 11; Stephen Bainbridge, 'Contemporary Issues in the Law of Business Organizations: Mandatory Disclosure: A Behavioural Analysis' (2000) 68 *University of Cincinnati Law Review* 1023.
10. Anne Beyer, Daniel Cohen, Thomas Lys and Beverly Walther, 'The Financial Reporting Environment: Review of the Recent Literature' (2010) 50 *Journal of Accounting and Economics* 296, 315–316.
11. James Boyle, 'A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading' (1992) 80 *California Law Review* 1413, 1433–1437.

the emphasis is on fairness and equality.[12] Once produced, information can be disseminated at virtually zero marginal cost.[13] However, information providers are unable to receive full value for their efforts, so they tend to under-produce unless a government or other third parties intervene.[14] Within private markets, information is a resource that cannot be infinitely distributed without diminishing its value.[15] Private resources are subject to the same economic laws as other goods within the private sphere.[16] An information provider requires a profit or an incentive to continue to produce, and rights to the information may therefore be required to avoid under-production and inefficient allocation.[17] Free markets are assumed to promote the most efficient or profitable outcomes – and equality is not a relevant concern.[18]

The complexities arising from the dual public/private nature of information are reflected in the company disclosure debates. When company information is considered a property right, it may be treated as a private or public resource. That is, the property right may remain with the company that generated the information, a non-exclusive right may be granted to third parties such as analysts, or the information may be considered a necessary public good.[19] These property right arguments represent an important limb of the mandatory disclosure theoretical debates. Scholars who criticise mandatory disclosure frameworks typically argue or imply that any rights to information generated by a public company are held by the company as a separate legal entity, and that company managers should retain discretion around whether to disclose information, who to disclose it to, and the form in which it is disclosed. As discussed more fully in Chapters 3 and 4, some of these commentators also believe that it is appropriate for company managers to provide information privately to third parties such as analysts on a selective basis. In contrast, other scholars argue for disclosure regulation that requires public disclosure of material company information, and for

12. Kimberly Krawiec, 'Fairness, Efficiency and Insider Trading: Deconstructing the Coin of the Realm in the Information Age' (2001) 95 *North Western University Law Review* 443, 453; James Boyle, 'A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading' (1992) 80 *California Law Review* 1413, 1438.
13. James Boyle, 'A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading' (1992) 80 *California Law Review* 1413, 1438.
14. James Boyle, 'A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading' (1992) 80 *California Law Review* 1413, 1439, 1445.
15. James Boyle, 'A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading' (1992) 80 *California Law Review* 1413, 1439.
16. James Boyle, 'A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading' (1992) 80 *California Law Review* 1413, 1439.
17. Kimberly Krawiec, 'Fairness, Efficiency and Insider Trading: Deconstructing the Coin of the Realm in the Information Age' (2001) 95 *North Western University Law Review* 443, 502.
18. Kimberly Krawiec, 'Fairness, Efficiency and Insider Trading: Deconstructing the Coin of the Realm in the Information Age' (2001) 95 *North Western University Law Review* 443, 460.
19. James Cox, 'Insider Trading and Contracting: A Critical Response to the "Chicago School"' (1986) 4 *Duke Law Journal* 628; Michael Whincorp, 'Towards A Property Rights and Market Microstructural Theory of Insider Trading Regulation - The Case of Primary Securities Markets Transactions' (1996) 7 *Journal of Business and Finance Law* 212; Jonathan Macey, 'Securities Trading: A Contractual Perspective' (1999) 50 *Case Western Reserve Law Review* 269; Stephen Choi, 'Regulating Investors Not Issuers: A Market-Based Proposal' (2000) 88 *California Law Review* 279; Edmund Kitch, 'Proposals for Reform of Securities Regulation: An Overview' (2001) 41 *Virginia Journal of International Law* 629.

insider trading and selective disclosure regulation that prohibits private or selective disclosure of material information that has not been disclosed publicly. This latter group of scholars typically draws on the public good theory of company information. The property right theories and arguments in relation to company information are closely connected to information incentive arguments, as decisions within listed companies concerning disclosure of company information are normally made by managers and are motivated by various incentives.

[B] Company Manager Information Incentives

When considering the incentives to provide and disseminate company information in financial markets, it is important to clearly differentiate between information generated and disclosed by a listed company and additional information and analysis provided by third parties outside of the company. This section discusses incentives within listed companies to provide information to market participants, while the next section considers third party information incentives.

Commentators agree that listed company managers have some incentives to voluntarily disclose information to the market. While listed companies are not generally required to disclose proprietary confidential information (even in countries with mandatory disclosure regimes),[20] some information must be disclosed to satisfy the demands for ongoing news from existing investors and encourage interest from potential investors.[21] Empirical research confirms that listed companies voluntarily disclose information when they need to raise new capital,[22] reduce information asymmetry,[23] or lower the cost of capital.[24] Managers may also voluntarily provide or verify information to mitigate litigation risks.[25] Critics argue that listed companies have sufficient incentives to ensure information provided to investors is credible and accurate without the need for mandatory disclosure regimes.[26] However, market variables that encourage high quality disclosure and optimal long-term performance do not always exist. Many listed companies operate for long periods without raising new

20. Ronald Dye, 'Disclosure of Nonproprietary Information' (1985) 23 *Journal of Accounting Research* 123. Certain categories of information possessed by a listed entity, which may otherwise go to value, are properly excluded from mandatory disclosure regimes.
21. Kimberly Krawiec, 'Fairness, Efficiency and Insider Trading: Deconstructing the Coin of the Realm in the Information Age' (2001) 95 *North Western University Law Review* 443, 489.
22. Roberta Romano, 'Empowering Investors: A Market Approach to Securities Regulation' (1998) 107 *Yale Law Journal* 2359, 2374; Richard Frankel, Maureen McNichols and G Peter Wilson, 'Discretionary Disclosure and External Financing' (1995) 70 *Accounting Review* 135, 141.
23. Maribeth Coller and Teri Yohn, 'Management Forecasts and Information Asymmetry: An Examination of Bid-Ask Spreads' (1997) 35 *Journal of Accounting Research* 181.
24. Christine Botosan, 'Evidence that Greater Disclosure Lowers the Cost of Equity Capital' (2000) 12 *Bank of America Journal of Applied Corporate Finance* 60.
25. See, e.g., Jennifer Francis, Douglas Philbrick and Katherine Schipper, 'Shareholder Litigation and Corporate Disclosures' (1994) 32 *Journal of Accounting Research* 137; Douglas Skinner, 'Earnings Disclosures and Stockholder Lawsuits' (1997) 23 *Journal of Accounting and Economics* 249.
26. Frank Easterbrook and Daniel Fischel, 'Mandatory Disclosure and the Protection of Investors' (1984) 70 *Virginia Law Review* 669, 673–676, 684, 694, 709; Roberta Romano, 'Empowering Investors: A Market Approach to Securities Regulation' (1998) 107 *Yale Law Journal* 2359, 2373.

capital, and a takeover bid may be avoided by participating in a buy-out or private equity bid, or by establishing takeover protections.[27] In these circumstances, the security prices may not accurately reflect their underlying economic value, thereby reducing the efficiency of the relevant market.

Senior executives are undoubtedly well positioned to provide valuable information about a company to the market because they manage the day-to-day operations of the business, and this provides them with a comprehensive and nuanced understanding of company developments and issues.[28] Nevertheless, there are significant information asymmetries between senior managers and outside investors and other stakeholders. And when short-term managerial incentives intrude on or dominate the corporate decision making processes, these differences in knowledge can be manipulated and abused. The primary areas of concern arise when managers have incentives to hide or disguise information needed by outsiders, such as impending losses that would significantly decrease security prices if discovered by outsiders. These incentives can be so powerful that some companies misrepresent or fail to disclose material information,[29] particularly when performance trends are negative or the company's financial position is ailing.[30]

Some commentators suggest that companies are forced to disclose unfavourable news, otherwise sophisticated institutional investors will interpret the lack of disclosure as bad news.[31] However, a company's silence does not provide unambiguous signals to the market of impending bad news. When negative corporate news is publicly announced, and it is clear that the relevant executives were aware of the information earlier than its public release, the prices of the company's listed securities may fall as a result of poor transparency and a loss of trust. Nonetheless, there are forceful countervailing motivations for managers to avoid disclosure of unfavourable news or to delay its public release, particularly when accountability or blame may attach. Public disclosure of negative events or issues may harm managers' reputations, employment prospects, and remuneration packages.

Private disclosure of company information allows managers to have control over information dissemination processes and limits their accountability for poor business

27. Zohar Goshen and Gideon Parchomovsky, 'The Essential Role Of Securities Regulation' (2006) 55 *Duke Law Journal* 711, 760–761.
28. See, e.g., Orie Barron, Charles Kile and Terrence O'Keefe, 'MD&A Quality and Analysts' Earnings Forecasts' (1999) 16 *Contemporary Accounting Research* 75; Michael Guttentag, 'An Argument for Imposing Disclosure Requirements on Public Companies' (2004) 32 *Florida State University Law Review* 123, 173.
29. See, e.g., Victor Brudney, 'Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws' (1979) 93 *Harvard Law Review* 322, 327.
30. Jennifer Arlen and William Carney, 'Vicarious Liability for Fraud on Securities Markets: Theory and Evidence' (1992) *University of Illinois Law Review* 691, 701; Marc Steinberg, 'Insider Trading, Selective Disclosure, and Prompt Disclosure: A Comparative Analysis' (2001) 22 *University of Pennsylvania Journal of International Economic Law* 635, 658; Zohar Goshen and Gideon Parchomovsky, 'The Essential Role Of Securities Regulation' (2006) 55 *Duke Law Journal* 711, 760.
31. Roberta Romano, 'The Need for Competition in International Securities Regulations' (2001) 2 *Theoretical Inquiries in Law* 387.

judgments and suboptimal company performance. Consequently, in voluntary disclosure environments, company information is likely to be disclosed privately to a narrow spectrum of investors, and the quantity and quality of publicly available information may be limited. Regulation that mandates public disclosure of all material price-sensitive information can assist to promote disclosure of negative corporate news. As Fama and Laffer noted in 1971:

> [i]n some cases where the firm would be the producer of information about itself, a social optimum can be achieved by means of legal disclosure provisions… That is, the firm is restricted by law both from selling information about itself and from giving preferential treatment to either its shareholders or outsiders in increasing information. Such a law destroys the firm's incentive to generate information for trading purposes.[32]

While empirical research indicates that many executives remain reluctant to disclose negative news even within mandatory disclosure jurisdictions,[33] potential action by public or private litigants can alter the disclosure incentive equation.

[C] Third Party Information Incentives

An assessment of potential gains in efficiency and fairness from the imposition of mandatory disclosure regulation requires assumptions to be made about the relationship between the information produced by listed companies and additional information provided by third parties. As will be discussed in Chapter 4, only minimal consideration has been given to this important area until now. While many scholars and practitioners assume that sell-side analyst research plays a critical role in enhancing share price efficiency,[34] the extent to which sell-side reports provide useful content and enhance financial market efficiency in addition to, and independent from, the information provided by companies remains open to question.

Many commentators claim that retail investors require professional analysts to interpret company information and to present it to them in a way that they can

32. Eugene Fama and Arthur Laffer, 'Information and Capital Markets' (1971) 44 *Journal of Business Law* 289, 298.
33. See, e.g., Wilbur Lewellen, Taewoo Park and Byung Ro, 'Self-Serving Behaviour in Managers' Discretionary Information Disclosure' (1996) 21 *Journal of Accounting and Economics* 227; Donald Langevoort, 'Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)' (1997) 146 *University of Pennsylvania Law Review* 101; Gregory Miller, 'Earnings Performance and Discretionary Disclosure Decisions' (2002) 40 *Journal of Accounting Research* 173; John Graham, Campbell Harvey and Shiva Rajgopal, 'The Economic Implications of Corporate Financial Reporting' (2005) 40 *Journal of Accounting and Economics* 3; SP Kothari, Susan Shu and Peter Wysocki, 'Do Managers Withhold Bad News?' (2009) 47 *Journal of Accounting Research* 241; Dushyantkumar Vyas, 'The Timeliness of Accounting Write-Downs by U.S. Financial Institutions During the Financial Crisis of 2007-2008' (2011) 49 *Journal of Accounting Research* 823; Catherine Schrand and Sarah Zechman, 'Executive Overconfidence and the Slippery Slope to Financial Misreporting' (2012) 53 *Journal of Accounting and Economics* 311.
34. See Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) *88 Iowa Law Review* 1035.

CHAPTER 4

Selective Disclosure

> Selective disclosure is inimical to a belief that a level playing field exists, as well as to its existence in fact.[1]

§4.01 OVERVIEW[2]

Selective disclosure is the release of information by companies to some investors, such as sell-side brokers and analysts and buy-side asset managers and analysts, without simultaneous public disclosure. At the heart of the selective disclosure debates is the assumed role of financial intermediaries, with many theoretical models assuming a privileged position for these market participants. The theoretical debates in the US provide a rich spectrum of views on the role of financial intermediaries and selective disclosure issues. These debates were especially vigorous during the 1990s when Regulation Fair Disclosure (Reg FD) was proposed.[3] The Reg FD debates are discussed in this chapter because they provide valuable insight on effective company disclosure regulation and practice.

§4.02 PRICE EFFICIENCY

Many of the selective disclosure theories and models overlap with those applicable to the mandatory disclosure and insider trading debates. Some commentators argue that trading on selectively disclosed information provides price signals to the market,

1. *Australian Securities and Investments Commission v. Southcorp Limited (No. 2)* (2003) 130 FCR 406, [36].
2. Some of the material in this Chapter was included in a published article: Gill North, 'A Theoretical Basis for Selective Disclosure Regulation' (2009) 32 *University of New South Wales Law Journal* 143.
3. United States Securities and Exchange Commission, *Proposed Rule: Selective Disclosure and Insider Trading* (2000).

thereby increasing share price accuracy and market efficiency.[4] These price efficiency theories are the same as those expounded by Manne in defence of insider trading, except that the participants trading on the private information are outsiders. The counter arguments are also similar. When such trading is permitted, noise and uncertain signals may result in increased speculative trading activity, leading to a reduction in share price accuracy and increased price volatility. In any event, when information revealed through outsider trading becomes public soon after the trading occurs, any price efficiency gains are restricted to a few hours or days, with little, if any, positive impact on capital allocations and economic outcomes. The primary effect of trading in these circumstances is a shift in wealth from uninformed to informed participants. That is, participants with information advantages benefit systematically at the expense of participants without such advantages.

Brudney points out that the history of securities legislation in the US suggests that Congress has long sought to protect public investors from exploitation of institutional informational advantages that cannot be lawfully overcome or offset.[5] However, some scholars argue that uninformed or unsophisticated investors do not require protection from selective disclosure because they are protected by, or can rely on, market efficiency.[6] As discussed in Chapters 2 and 3, these arguments require further explanation to be credible, because uninformed investors are not protected when trading against counterparties with valuable private information unless the relevant financial market is strong form efficient under Fama's ECMH. Other commentators suggest that individual investors can gain access to private information by buying the information from an intermediary or investing with a fund manager.[7] This argument assumes that individuals should only invest with the assistance of professional advice

4. Stephen Choi, 'Selective Disclosure in the Public Capital Markets' (2002) 35 *UC Davis Law Review* 533, 535, 541; Ian Ayres and Stephen Choi, 'Internalizing Outsider Trading' (2002) 101 *Michigan Law Review* 313; John Barry, 'The Economics of Outside Information and Rule 10b-5' (1981) 129 *University of Pennsylvania Law Review* 1307, 1330; Merritt Fox, 'Required Disclosure and Corporate Governance' (1996) 62 *Law and Contemporary Problems* 113, 115–116. See also Paul Brountas Jr, 'Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts' (1992) 92 *Columbia Law Review* 1517, 1533; Christopher Donald, 'A Critique of Arguments for Mandatory Continuous Disclosure' (1999) 62 *Saskatchewan Law Review* 85, 112–115.
5. Victor Brudney, 'Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws' (1979) 93 *Harvard Law Review* 322, 357, 360.
6. Christopher Saari, 'The Efficient Capital Markets Hypothesis, Economic Theory and the Regulation of the Securities Industry' (1977) 29 *Stanford Law Review* 1031, 1076; Frank Easterbrook and Daniel Fischel, 'Mandatory Disclosure and the Protection of Investors' (1984) 70 *Virginia Law Review* 669, 693–694; Roberta Romano, 'Empowering Investors: A Market Approach to Securities Regulation' (1998) 107 *Yale Law Journal* 2359, 2378; Christopher Donald, 'A Critique of Arguments for Mandatory Continuous Disclosure' (1999) 62 *Saskatchewan Law Review* 85, 112–115; Daniel Fischel, 'Symposium on Insider Trading: Insider Trading and Investment Analysts: An Economic Analysis of *Dirks v. Securities and Exchange Commission*' (1984) 13 *Hofstra Law Review* 127, 146.
7. See, e.g., Daniel Fischel, 'Symposium on Insider Trading: Insider Trading and Investment Analysts: An Economic Analysis of *Dirks v. Securities and Exchange Commission*' (1984) 13 *Hofstra Law Review* 127, 146; Christopher Saari, 'The Efficient Capital Markets Hypothesis, Economic Theory and the Regulation of the Securities Industry' (1977) 29 *Stanford Law Review* 1031.

or management, and is a paternalistic argument that closely aligns with an intermediated model of financial markets.

§4.03 INTERMEDIARY, ANALYST AND RESEARCH INCENTIVES

Most selective disclosure theories are centred on intermediary, analyst, and research incentives. These theories assume that intermediaries play a critical role within financial markets and therefore require privileged information. Traditional scholarly literature suggests that analysts require the right to obtain and use private company information in return for enhancing market efficiency by the provision of independent analysis and research.[8] It is assumed that analysts undertake all necessary discovery of security related information because they have the required education, experience, resources, and economies of scale to collect, analyse and produce information efficiently.[9] They are portrayed as 'crucial players in the mechanisms of market place efficiency that lead to optimal allocation of capital resources.'[10] The broader public are assumed to benefit from the work of analysts because the information discovered by analysts leads to more accurate or efficient security prices.[11]

Some commentators claim that selective disclosure is needed as an incentive for financial analysts to enter or remain in the market.[12] Barry indicates that stock trading based on selective disclosures prior to the publishing of research 'provides a just return for legitimate industry and encourages economically efficient behaviour.'[13] Fischel suggests the primary reason clients use an analyst is to obtain superior information and to thereby obtain higher returns.[14] He claims that '[n]obody will pay an analyst for

8. Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035.
9. See, e.g., Zohar Goshen and Gideon Parchomovsky, 'The Essential Role Of Securities Regulation' (2006) 55 *Duke Law Journal* 711, 722–725; Dennis Corgill, 'Insider Trading, Price Signals and Noisy Information' (1996) 71 *Indiana Law Journal* 355, 397.
10. Donald Langevoort, 'Investment Analysts and the Law of Insider Trading' (1990) 76 *Virginia Law Review* 1023, 1024.
11. Scott Russell, 'Regulation Fair Disclosure: The Death of the Efficient Capital Market Hypothesis and the Birth of Herd Behaviour' (2002) 82 *Boston University Law Review* 527, 550.
12. John Barry, 'The Economics of Outside Information and Rule 10b-5' (1981) 129 *University of Pennsylvania Law Review* 1307, 1353, 1387–1388; Dennis Corgill, 'Insider Trading, Price Signals and Noisy Information' (1996) 71 *Indiana Law Journal* 355, 397–398; Stephen Choi and Eric Talley, 'Playing Favorites With Shareholders' (2002) 75 *Southern California Law Review* 271, 310; Stephen Choi, 'Selective Disclosure in the Public Capital Markets' (2002) 35 *UC Davis Law Review* 533, 545; Paul Brountas Jr, 'Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts' (1992) 92 *Columbia Law Review* 1517, 1540; Bruce Kobayashi and Larry Ribstein, 'Outsider Trading as an Incentive Device' (2006) 40 *UC Davis Law Review* 21, 31.
13. John Barry, 'The Economics of Outside Information and Rule 10b-5' (1981) 129 *University of Pennsylvania Law Review* 1307, 1388. See also Dennis Corgill, 'Insider Trading, Price Signals and Noisy Information' (1996) 71 *Indiana Law Journal* 355, 397–398, 416–1417.
14. Daniel Fischel, 'Symposium on Insider Trading: Insider Trading and Investment Analysts: An Economic Analysis of *Dirks v. Securities and Exchange Commission*' (1984) 13 *Hofstra Law Review* 127, 144.

information that he must publicly disclose before selling it to his clients.'[15] Choi and Barry argue that giving possessors of outside information a right to trade without disclosure preserves the necessary incentives for private analysis.[16] Brountas advocates the use of analysts as a filter to provide credibility to the information so it enters the public arena in a format that is more easily understandable by other investors.[17] Some scholars extend these arguments and suggest that trading profits from selective disclosure provide compensation for professional research efforts, but not at the expense of uninformed or unsophisticated investors.[18] However, secondary trading within financial markets is zero sum. It is, therefore, incorrect to claim that trading on selectively disclosed information will produce a gain for the trading party, while other uninformed investors will not make a corresponding loss.

Many of the traditional intermediary assumptions are no longer relevant or credible in modern financial markets. First, no compelling evidence has been found to support the theory that selective disclosure is required to incentivise analysts to produce research, which in turn is required to enhance market efficiency. As Lee notes, 'the argument for the necessity of speculative profits rests on untested, debatable assumptions about the absence of other incentives for investment in information.'[19] The relationships or links between access to company information, selective disclosure, research production and efficiency are weak and ill-defined, and the impacts of specific analyst research strategies on market and economic efficiency are still poorly understood.[20] In particular, the extent (and incremental value) of third party research on listed companies, such as sell-side analyst research and information, remains unclear.[21] To be of value, such research needs to provide genuinely independent information and analysis and critique of publicly available information, rather than a mere regurgitation of information received privately from company managers.

Second, the arguments that categorise participants entitled to receive private company information as 'analysts' or 'research providers' require further explanation.

15. Daniel Fischel, 'Symposium on Insider Trading: Insider Trading and Investment Analysts: An Economic Analysis of *Dirks v. Securities and Exchange Commission*' (1984) 13 *Hofstra Law Review* 127, 145.
16. Stephen Choi, 'Selective Disclosure in the Public Capital Markets' (2002) 35 *UC Davis Law Review* 533, 544–545; John Barry, 'The Economics of Outside Information and Rule 10b-5' (1981) 129 *University of Pennsylvania Law Review* 1307, 1353.
17. Paul Brountas Jr, 'Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts' (1992) 92 *Columbia Law Review* 1517, 1540.
18. See, e.g., Daniel Fischel, 'Symposium on Insider Trading: Insider Trading and Investment Analysts: An Economic Analysis of *Dirks v. Securities and Exchange Commission*' (1984) 13 *Hofstra Law Review* 127, 146; Homer Kripke, *The SEC And Corporate Disclosure: Regulation In Search Of A Purpose* (Harcourt Brace Jovanovich Publishers, New York, 1979) 14–16, 284–286.
19. Ian Lee, 'Fairness and Insider Trading' (2002) 1 *Columbia Business Law Review* 119, 175.
20. Jeffrey Gordon and Lewis Kornhauser, 'Efficient Markets, Costly Information and Securities Research' (1985) 60 *New York University Law Review* 761, 792. See also Frank Easterbrook, 'Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information' (1981) *Supreme Court Review* 309, 364; James Boyle, 'A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading' (1992) 80 *California Law Review* 1413, 1452.
21. See, e.g., Ian Ayres and Stephen Choi, 'Internalizing Outsider Trading' (2002) 101 *Michigan Law Review* 313.

Company managers do not formally determine which participants are provided with access to private company information based on analytical skills or research production. Investors operate in a competitive market and the incentives to discover valuable information are powerful across all participant groups and not merely those labelled 'analysts'. The groups of investors that senior company executives typically meet with include sell-side brokers and analysts, buy-side analysts and asset managers, and wealthy families and individuals. Although sell-side brokers and analysts produce research reports for other participants, buy-side analysts and asset managers and individuals do not. Buy-side analysts and asset managers who meet with senior executives generally want to ensure their actual or potential investment in a company is sound and likely to produce optimal returns. Put simply, their primary purpose for attending private briefings is to obtain information to enhance portfolio returns. As most investors operate using this *modus operandi*, the theoretical (and practical) rationales for providing only some of these participants with private access remain uncertain.

Third, no compelling evidence has been found suggesting the security prices of companies not covered by analysts are inefficient primarily because of a lack of sell-side analyst coverage.[22] Many listed companies assume analyst coverage is necessary to build a market profile, encourage investor interest, and successfully raise new capital. While potential commissions or investment banking business options are sometimes insufficient for institutions to justify initiating or maintaining sell-side analyst coverage, particularly for smaller companies, these companies now have many communication options to convey their 'story' directly to potential institutional and retail investors. There are specialist funds that invest in companies with smaller market capitalisations in all major markets, and there are retail investors who are well-informed about these particular companies and securities. Searches for mis-valued stocks and informational advantages in contemporary markets are fiercely competitive, so investment opportunities that represent reasonable value will generally attract investor interest and capital, regardless of analyst coverage and size of company.

Finally, some companies argue that they need to disseminate information privately as incentive for analysts to produce research.[23] Kripke suggests that forcing companies to publicly disclose information may increase information production costs, making it more difficult to reduce information disparities.[24] Similar theories and arguments were discussed in Chapter 2. In reality, the cost of publicly disclosing comprehensive information using digital technologies is generally much less than the cost of privately disclosing similar information at a series of meetings with individual participants.

22. While there are empirical studies that measure the incremental impact of analyst initiation, the causal effects are not clear.
23. Donald Langevoort, 'Investment Analysts and the Law of Insider Trading' (1990) 76 *Virginia Law Review* 1023, 1029–1031; Paul Brountas Jr, 'Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts' (1992) 92 *Columbia Law Review* 1517, 1540.
24. Daniel Fischel, 'Symposium on Insider Trading: Insider Trading and Investment Analysts: An Economic Analysis of *Dirks v. Securities and Exchange Commission*' (1984) 13 *Hofstra Law Review* 127, 145.

Some commentators argue that selective disclosure is necessary to compensate analysts for their continuous monitoring of a company. As discussed in Chapter 2, some commentators suggest analysts act as unbiased market gatekeepers, resulting in lower agency costs and therefore enhanced market efficiency.[25] Fischel argues that the fact that companies 'voluntarily transmit information to analysts suggests the use of analysts is an efficient method of communicating information.'[26] Other scholars question these agency and analyst efficiency claims. In voluntary disclosure environments, managers may limit disclosure to a select group of shareholders in order to optimise the short-term profits of the recipients and managers, rather than the long-term company performance.[27]

There are many conflicts of interest that exist when information is selectively disclosed to analysts or investors. This is because company managers and institutional participants have powerful incentives to engage in selective disclosure. When managers receive a large proportion of their remuneration as bonuses or stock options, selective disclosure may be used to artificially maintain or increase share prices.[28] Companies can also restrict the provision of information to analysts most likely to publish positive research recommendations,[29] or to those likely to provide the company with new capital,[30] and may blacklist or 'freeze out' analysts who issue negative recommendations or criticise the company.[31] If the relationships between managers and analysts and other favoured investors become too close, management may feel

25. Stephen Thurber, 'The Insider Trading Compensation Contract as an Inducement to Monitoring by the Institutional Investor' (1994) 1 *George Mason University Law Review* 119, 134; Cf John Coffee Jnr, 'What Caused Enron? A Capsule Of Social and Economic History of the 1990s' (2003) 89 *Cornell Law Review* 269 286–289.
26. Daniel Fischel, 'Symposium on Insider Trading: Insider Trading and Investment Analysts: An Economic Analysis of *Dirks v. Securities and Exchange Commission*' (1984) 13 *Hofstra Law Review* 127, 144.
27. See, e.g., Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) *88 Iowa Law Review* 1035, 1053–1056; Ronald Gilson and Reinier Kraakman, 'The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias' (2003) 28 *Journal of Corporation Law* 715, 736–737.
28. Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1090; Victor Brudney, 'Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws' (1979) 93 *Harvard Law Review* 322, 335.
29. See, e.g., Bin Ke and Yong Yu, 'The Effect Of Issuing Biased Earnings Forecasts On Analysts' Access To Management And Survival' (2006) 44 *Journal of Accounting Research* 965; Donald Langevoort, 'Investment Analysts and the Law of Insider Trading' (1990) 76 *Virginia Law Review* 1023, 1041; Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1054.
30. Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1056.
31. Donald Langevoort, 'Investment Analysts and the Law of Insider Trading' (1990) 76 *Virginia Law Review* 1023, 1042; Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1054. John Olsen the Merrill Lynch energy market securities analyst was fired when he downgraded Enron's stock. Similarly, analysts who criticized HIH Insurance were blacklisted.

pressured to manipulate or massage the company results, or even to adjust the corporate strategy, in order to satisfy analyst expectations.[32]

The recipients of selective disclosures also face a variety of potential conflicts. First, those who are privy to material private information can choose to profitably trade on disclosed information.[33] For example, participants that are selectively forewarned of bad news from a company can sell securities in advance of other investors.[34] Asset managers often prefer to exit when companies are in trouble rather than demanding governance changes from management.[35] Second, when sell-side analyst access to private information is dependent on a favoured relationship with company managers, this can encourage biased research.[36] Third, when sell-side analysts publish research including information obtained from a company privately, the content may be disseminated to their clients on a preferential basis.[37] Fourth, when commissions paid to buy-side analysts or fund managers are tied to brokerage levels or investment banking revenue within the same institution, this can pressure analysts to produce particular recommendations in order to increase their salaries or bonuses.[38] Gilson and Kraakman suggest that when they first published on the mechanisms of market efficiency, they should have been more sceptical of market institutions, incentives, and performance.[39] They note that they failed to appreciate the scale of the incentive problems in financial institutions that produce information about listed corporations.[40] They admit they were

32. Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1056.
33. Donald Langevoort, 'Investment Analysts and the Law of Insider Trading' (1990) 76 *Virginia Law Review* 1023, 1042; Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1044.
34. Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1090; Stephen Choi, 'Selective Disclosure in the Public Capital Markets' (2002) 35 *UC Davis Law Review* 533, 549.
35. John Coffee, 'Liquidity versus Control: The Institutional Investor as Corporate Monitor' (1991) 91 *Columbia Law Review* 1277, 1288; Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1088; Stephen Choi, 'Selective Disclosure in the Public Capital Markets' (2002) 35 *UC Davis Law Review* 533, 549, 555; Ian Ayres and Stephen Choi, 'Internalizing Outsider Trading' (2002) 101 *Michigan Law Review* 313.
36. Merritt Fox, 'Regulation FD and Foreign Issuers: Globalisation's Strains and Opportunities' (2001) 41 *Virginia Journal of International Law* 653, 657, 677; Stephen Choi, 'Selective Disclosure in the Public Capital Markets' (2002) 35 *UC Davis Law Review* 533, 548.
37. Paul Brountas Jr, 'Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts' (1992) 92 *Columbia Law Review* 1517, 1546.
38. See, e.g., Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1045–1046; Hsiou-Wei Lin and Maureen McNichols, 'Underwriting Relationships, Analysts Earning Forecasts And Investment Recommendations' (1998) 25 *Journal of Accounting & Economics* 101, 124–125; Harrison Hong and Jeremy Kubik 'Analysing The Analysts: Career Concerns and Biased Earnings Forecasts' (2003) 58 *Journal of Finance* 313.
39. Ronald Gilson and Reinier Kraakman, 'The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias' (2003) 28 *Journal of Corporation Law* 715, 736–737.
40. Ronald Gilson and Reinier Kraakman, 'The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias' (2003) 28 *Journal of Corporation Law* 715, 736.

naïve about the role of security analysts, particularly those on the sell-side of the market.[41]

All of the outlined conflicts of interest and biases have the potential to increase agency costs and to thereby interfere with an efficient allocation of capital.[42]

§4.04 JUDICIAL COMMENTARY

The courts in the US have generally accepted a series of traditional assumptions concerning the role of analysts. For instance, in *Securities and Exchange Commission v. Bausch & Lomb Inc,* Ward J of the District Court held that Bausch & Lomb had not disclosed material non-public information to securities analysts during interviews. Although the Chairman released an earnings estimate to securities analysts and did disclose material, non-public corporate information, the act was held to be an 'uncharacteristic and inadvertent' slip and not accompanied by the requisite intent. Ward J indicated [at 123] that:

> [a]nalysts provide a needed service in culling and sifting available data, viewing it in light of their own knowledge of a particular industry and ultimately furnishing a distilled product in the form of reports. These analyses can then be used by both the ordinary investor and by the professional investment advisor as a basis for the decision to buy or sell a given stock. The data available to the analyst – his raw material – comes in part from published sources but must also come from communication with management.[43]

This commentary indicates that Ward J assumed that analysts are entitled to obtain private information from managers directly, and that ordinary investors require information that has been filtered by analysts. These assumptions continue to be important elements of selective disclosure debates and policy developments around the world.

The liability of analysts to insider trading was left ambiguous in *Dirks v. SEC.* 463 US 646 (1983). Justice Powell J speaking for the majority indicated [at 658] that:

> [i]mposing a duty to disclose or abstain solely because a person knowingly receives material non-public information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market. It is commonplace for analysts to 'ferret out and analyze information'.

41. Ronald Gilson and Reinier Kraakman, 'The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias' (2003) 28 *Journal of Corporation Law* 715, 737.
42. Donald Langevoort, 'Investment Analysts and the Law of Insider Trading' (1990) 76 *Virginia Law Review* 1023, 1025; Jill Fisch and Hillary Sale, 'The Securities Analysts as Agent: Rethinking the Regulation of Analysts' (2003) *88 Iowa Law Review* 1035, 1079, 1097–1098. A conflict of interest exists when a party to a transaction can gain by taking actions that are detrimental to its counterparty.
43. *SEC v. Bausch & Lomb, Inc* 420 F. Supp. 1226 (1976) 1230.

Powell J further noted [at 659] that the nature of non-public information received by analysts from corporate officers and insiders at briefings is such that this information cannot be made simultaneously available to all of the corporation's stock holders or the public generally … Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses; neither corporate insiders nor analysts can be sure when the line is crossed.[44]

Thus Powell J assumed that the mosaic of information provided to financial intermediaries and analysts is, and should be, different from publicly released information because companies cannot provide the same information to all participants simultaneously.

Assumed differences between market participant groups are reflected in case law in other jurisdictions. For instance, in Australia, the case *Forrest v. Australian Securities and Investments Commission; Fortescue Metals Group Ltd v. Australian Securities and Investments Commission* [2012] HCA 39 (Fortescue) involved alleged misleading or deceptive conduct. Misleading and deceptive conduct requires identifying the relevant audience that was, or potentially could have been, misled or deceived. Heydon J of the High Court of Australia characterised the audience of the public disclosures of Fortescue Metals Group Limited, a large iron ore company, as comprised of 'superannuation funds, other large institutions, other wealthy investors, stock brokers and other financial advisers, specialised financial journalists, as well as smaller investors reliant on advice.'[45] In doing so, His Honour effectively placed investors into two classes, the first comprised of astute, sophisticated and well-informed large investors, and the other comprised of inexperienced and unsophisticated smaller investors[46] reliant on intermediary advice. These assumed links between institutions, wealth, sophistication, commercial knowledge, and large shareholdings, and between smaller investors and a requirement for intermediary advice, were not explained by Heydon J or supported by evidence.

The accuracy of assumptions about the role of analysts and the financial skill and knowledge of various investor groups is highly debatable in the context of modern financial markets. Rapid advances in digital technologies have fundamentally altered the substance of debates concerning access to listed company information and the need for intermediaries to control and filter company information and to broker the trading of company securities. In digital environments, listed companies can easily and cheaply disseminate information simultaneously to interested participants through security exchanges or information repositories. Online trading services that allow clients to invest and trade for fees without research cost loadings are also well-established. The SEC was an early responder in this new environment.

44. *Dirks v. Securities and Exchange* 463 US 646, 659 (1983).
45. *Forrest v. Australian Securities and Investments Commission; Fortescue Metals Group Ltd v. Australian Securities and Investments Commission* [2012] HCA 39, [105].
46. The phrase 'smaller investor' is not explained. It may mean investors that have made a small investment in a particular security or investors that have small investment portfolios.

disclosure by listed entities.[3] These principles are outlined and discussed in Chapter 13, and are considered when determining the essential components of best practice disclosure frameworks in Part V of the book.

Periodic and continuous disclosure regimes are intended to operate together to ensure that listed companies disclose and communicate their objectives, strategies, positions and performance effectively within public forums. Part IV concludes that company disclosure regimes only achieve the IOSCO objectives and principles when the publicly available information from listed companies is sufficiently regular, complete, and timely to enable meaningful decision making and engagement by all groups with a warrantable interest, including members of the public.

3. Technical Committee of the International Organization of Securities Commission, *Principles For Periodic Disclosure By Listed Entitles Final Report* (February 2010).

CHAPTER 12
Singapore

> The profit motive of a demutualised exchange creates a natural tension between its regulatory responsibilities and duty to the public, and its shareholders. This natural tension gives rise to … conflict issues … A mutual exchange needs to balance the interests of its 'member-owners' with the interests of the investing public in [its] decision making and rule-making.[1]

§12.01 OVERVIEW

The Singapore Exchange (SGX) is the only securities exchange in Singapore. The SGX listed on its own market in 2000,[2] and is a self-regulatory organisation with oversight from the government regulator, the Monetary Authority of Singapore (MAS). The processes to manage potential conflicts within the SGX include the Risk Management and Regulation Group, which bears frontline and operational responsibility for ensuring that SGX's regulatory functions are not compromised by its commercial function, and the Regulatory Conflicts Committee,[3] which supervises the management of conflicts on behalf of the SGX Board. More broadly, the MAS oversees the SGX and reinforces its management of conflicts by:

- Undertaking an annual assessment of the SGX in relation to compliance with its obligations under the *Securities & Futures Act 2002* (Singapore).
- Reviewing changes to the listing rules.

1. SGX Ltd, 'Rule Making and SRO', 7 June 2012, http://www.sgx.com/wps/wcm/connect/cp_en/site/regulation/rulemaking_and_sro/Rule-making+and+SRO+Page?presentationtemplate=design_lib/PT_Printer_Friendly. The website with this commentary is no longer available.
2. Singapore Exchange, *Annual Report 2010*, 6.
3. The Regulatory Conflicts Committee (RCC) is a specialised board committee comprised of directors who are independent from management and business relationships with SGX. The Committee was established in 2005 to ensure that the SGX Board gives due regard to SGX's public interest obligations, as well as its duty to SGX shareholders. The key responsibilities of the RCC include: overseeing the arrangements within SGX for managing SRO conflicts; assisting in decision making in specific cases of SRO conflicts; and monitoring the adequacy of financial, human and system resources that SGX allocates to support its regulatory function.

- Issuing directives to SGX if and when required.
- Regulating the SGX listing under the SGX Listing Manual and monitoring trading in SGX's shares.

The SGX includes a mainboard and Catalist.[4] Many parties expect Asia to be the primary focus for growth of new listings and securities trading over the next decade, with much of this growth coming from the listing of Chinese companies. The SGX listing requirements were made more onerous during 2012 in an attempt to establish Singapore as the financial centre for Asia and to attract higher quality companies and larger initial public capital raisings.[5] More than 40% of the listings on the SGX are foreign based.[6]

§12.02 PERIODIC REPORTS

The main periodic disclosure rules are contained in SGX Listing Rule 705 and Appendix 7.2 of the SGX Listing Manual. These SGX rules require full year, half yearly and quarterly reports.[7] Financial statements for a full financial year must be announced immediately after the figures are available, and not later than sixty days after the end of the period.[8] The financial statements for each of the first three quarters of a financial year must be announced once the figures are available and not later than forty-five days after the quarter end if the company's market capitalisation exceeds SGD 75 million.[9]

Appendix 7.2 outlines the individual items of information that must be included in the income statement, statement of financial position and cash flow statement. It also requires a review of the performance of the group, including discussion of the following:

(a) any significant factors that affected the turnover, costs, and earnings of the group for the current financial period reported on, including (where applicable) seasonal or cyclical factors; and
(b) any material factors that affected the cash flow, working capital, assets or liabilities of the group during the current financial period reported on.[10]

Commentary must be provided on the significant trends and competitive conditions of the industry in which the group operates and any known factors or events that may affect the group in the next reporting period and the next twelve months.[11] Further, where a forecast or prospect statement has been previously disclosed to

4. Catalist listed companies are directly supervised by their sponsors.
5. Jeremy Grant, 'Singapore Exchange Tightens Listing Rules', *FT.com* 19 July 2012. Companies must have minimum market capitalisation of SGD 150 million and they must have an operating record of three years, including a minimum pre-tax profit of SGD 30 million for the most recent year.
6. Jeremy Grant, 'Singapore Exchange Tightens Listing Rules', *FT.com* 19 July 2012.
7. SGX Listing Manual, Rule 705, Appendix 7.2.
8. SGX Listing Manual, Rule 705(1).
9. SGX Listing Manual, Rule 705(2).
10. SGX Listing Manual, Rule 705, Appendix 7.2.8.
11. SGX Listing Manual, Rule 705, Appendix 7.2.10.

shareholders, any variance between it and the actual results must be disclosed.[12] Additional information required in the full year announcement includes segmental results, a sales breakdown and commentary on the factors leading to any material changes in contributions to turnover and earnings by the business or geographical segments.[13] The quarterly or half yearly reports must contain a statement from the board of directors confirming that, to the best of their knowledge, nothing has come to their attention which may render the financial statements to be false or misleading in any material respect.[14] Life science companies and mineral, oil and gas companies that are unable to meet specified profit criteria must provide a quarterly announcement on the use of funds or cash for the quarter and a projection on the use of funds or cash for the next quarter.[15]

Listed companies must issue their annual report to shareholders and the SGX within four months of the end of the financial year and at least fourteen days prior to the annual general meeting.[16] The Chairman's statement in the annual report must provide a balanced and readable summary of the company's performance and prospects.[17] Singapore has a Code of Corporate Governance (SGX Code) that comes under the purview of the SGX and the MAS.[18] While compliance with the SGX Code is not mandatory, the listing rules require companies to disclose their corporate governance practices and to provide explanations in their annual report concerning any non-compliance with the SGX Code.[19]

§12.03 CONTINUOUS DISCLOSURE

The main continuous disclosure obligation is provided in SGX Listing Rule 703 and this rule has statutory support in section 203 of the *Securities & Futures Act 2002* (Singapore).[20] Under SGX Listing Rule 703, an issuer must disclose information that is (a) necessary to avoid the establishment of a false market in its securities, or (b) that would be likely to have a material effect on the price or value of its securities. All material information must be disclosed even when the information is already publicly available. The disclosures are released through the SGX website. Section 203(2) of the *Securities & Futures Act 2002* (Singapore)[21] provides that:

12. SGX Listing Manual, Rule 705, Appendix 7.2.9.
13. SGX Listing Manual, Rule 705(15)(16)(17).
14. SGX Listing Manual, Rule 705(5).
15. SGX Listing Manual, Rule 705(6).
16. SGX Listing Manual, Rule 707(1)(2).
17. SGX Listing Manual, Rule 708.
18. SGX, *Code of Corporate Governance 2012.*
19. SGX Listing Manual, Rule 710.
20. *Securities & Futures Act 2002* (Singapore) s. 203.
21. Section 203 of the *Securities & Futures Act 2002* (Singapore) states that:

(1) This section shall, apply to:
(a) a corporation which is admitted to the official list of a securities exchange; or
(b) a responsible person of a collective investment scheme the units of which are quoted on a securities exchange, if the corporation or responsible person is required by the listing rules of the securities exchange to notify the securities exchange of information

The corporations or responsible person must not intentionally, recklessly, or negligently fail to notify the securities exchange of such information as is required to be disclosed under the listing rules of the securities exchange.

The SGX Listing Manual indicates that a public announcement should be factual, clear and succinct, it must contain sufficient quantitative information to allow investors to evaluate its relative importance to the activities of the issuer, and it should be balanced and fair.[22]

The SGX is responsible for monitoring and enforcing the continuous disclosure obligations. The SGX has a 'Regulators Column' to keep market participants informed about regulatory philosophy, processes and practices, as well as emerging issues and market developments. The Market Surveillance and Enforcement Department (MSE Department) of the SGX uses a real-time market surveillance system to monitor unusual price and volume movements of a company's securities. When potentially questionable transactions are identified, the MSE Department may query the relevant company verbally or in writing.[23] There is a disciplinary tribunal within the SGX structure governing issuer matters. A disciplinary committee hears the charges and decides whether the member has violated any rules or requirements of the exchange and, if so, decides the appropriate penalty. An appeal can be made to either the Disciplinary Committee or Appeals Committee, both of which are independent of the SGX, and the decision of the Committee is final. A member charged may be reprimanded, fined, suspended and or expelled.[24] The exchange operates a website that lists 'past disciplinary actions' taken by the Disciplinary and Appeals Committees against offenders who have breached SGX rules. When viewed, some of these actions involved disclosure matters.[25]

§12.04 EMPIRICAL EVIDENCE

[A] Case Studies

The companies selected for review were Singapore Telecommunications Ltd and Keppel Corporation, two of the largest entities listed on the SGX.

on specified events or matters as they occur or arise for the purpose of the securities exchange making that information available to a securities market operated by the securities exchange.

(2) The corporations or responsible person must not intentionally, recklessly, or negligently fail to notify the securities exchange of such information as is required to be disclosed under the listing rules of the securities exchange.

(3) Notwithstanding s. 204, a contravention of subsection (2) shall not be an offence unless the failure to notify is intentional or reckless.

22. SGK Listing Manual A-9, A-15.
23. SGX-ST Listing Rules Practice Note 7.2 Queries Regarding Unusual Trading Activity 1-2.
24. A disciplinary committee hears the charges and decides whether the member has violated any rules and requirements of the exchange; and if so, decides the appropriate penalty. An appeal to a committee independent of the SGX is allowed and the decision of this Committee is final.
25. See SGX Ltd, 'Past Disciplinary Actions', viewed 19 May 2015, http://www.sgx.com/wps/portal/sgxweb/home/regulation/consult_pub/past_dis_action.

[1] Singapore Telecommunications Limited

Singapore Telecommunications Limited (Singtel) is the largest listed company on the Singapore Exchange. The result material for the final quarter and year ended 31 March 2015 is presented coherently and includes detailed information on the internal and external environments. Further, the news release and presentation contain an outlook section that includes guidance on capital expenditure, free cash flow, dividends, revenue and EBITDA.

[2] Keppel Corporation

The business segments of Keppel Corporation (Keppel) include offshore and marine, infrastructure, property and investments. The key financials for the first quarter of 2015 include the net order book and contracts secured for the last ten years. This is useful information for people wanting to comprehend the linkages and lead times between orders, contracts and the financial results, and the regularity and recurring nature (or otherwise) of the various businesses.

CHAPTER 13

Periodic Disclosure Regulation and Practice

> Periodic reports facilitate investor decision making and monitoring of the markets by making it possible for investors to compare the performance of the same company over regular intervals, and by enabling investors to make useful comparisons among different companies.[1]

§13.01 OVERVIEW

In 1998, IOSCO adopted a comprehensive set of Objectives and Principles of Securities Regulation (IOSCO Principles) that seek to facilitate cross-border cooperation, reduce global systemic risk, protect investors, and ensure fair, efficient and transparent financial markets. The Technical Committee of IOSCO acknowledges the need for, and importance of, regular reporting by public companies in addition to disclosure on an ad hoc basis throughout a financial year.[2] IOSCO confirms that financial information in periodic reports is the core information around which related information, such as MD&A of historical results and prospects, should be framed.[3]

§13.02 PERIODIC DISCLOSURE KEY PRINCIPLES

The IOSCO Principles for periodic disclosure naturally fit within two categories; namely, public access and review, and the form and content of disclosures. The IOSCO public access and review principles encompass the following:

- the reports should be provided to the public in a timely manner;

1. Technical Committee of the International Organization of Securities Commission, *Principles For Periodic Disclosure By Listed Entitles* Final Report (February 2010) 4.
2. Technical Committee of the International Organization of Securities Commission, *Principles For Periodic Disclosure By Listed Entitles* Final Report (February 2010) 4.
3. Technical Committee of the International Organization of Securities Commission, *Principles For Periodic Disclosure By Listed Entitles* Final Report (February 2010) 4.

- the reports should be stored in a central location that facilitates public access to the information;
- all investors should have equal access to the information contained in periodic reports;
- when a company is listed in more than one jurisdiction, material information should be released promptly to each relevant market; and
- the reports should be filed with the relevant regulator for review.[4]

The IOSCO disclosure form and content principles include the following:

- the periodic reports should contain relevant information;
- the reports should be presented in a format that facilitates ready analysis of the information;
- information should be presented in a clear and concise manner;
- the reports should not be misleading or deceptive, omit any material information or rely on boilerplate language;
- the persons responsible for the financial statements should be clearly identified and these individuals should be required to state that the financial information provided is fairly presented; and
- the financial reporting internal controls should be subject to ongoing review.[5]

IOSCO indicates that the content of periodic reports should include at a minimum:

- audited consolidated financial statements that conform with internationally accepted accounting standards;
- information relating to the financial position, performance and cash flows of a company to allow liquidity and solvency assessments;
- an audit report;
- an outline of any significant changes that have occurred since the end of the financial year; and
- MD&A of the reported financial position and performance, and of the factors and trends expected to have a material impact on the company's future operations and performance.[6]

Policy makers, regulators and listed corporations in the countries reviewed appear to broadly accept the IOSCO Principles. The areas involving the most differences and contention include the following:

(1) the clarity, completeness and accuracy of company information provided;
(2) the regularity of periodic reporting, most notably an obligation to report quarterly;

4. Technical Committee of the International Organization of Securities Commission, *Principles For Periodic Disclosure By Listed Entitles* Final Report (February 2010) 7–28.
5. Technical Committee of the International Organization of Securities Commission, *Principles For Periodic Disclosure By Listed Entitles* Final Report (February 2010) 7–28.
6. Technical Committee of the International Organization of Securities Commission, *Principles For Periodic Disclosure By Listed Entitles* Final Report (February 2010) 7–28.

(3) the nature and scope of required MD&A;
(4) the timeliness of disclosure of 'bad news';
(5) the use and referencing of numbers that have not been calculated in accordance with accounting standards;
(6) the presentation of financial and non-financial information using standard forms;
(7) the role and content of preliminary final reports and annual reports;
(8) the provision of long-term performance data and commentary, including specific key performance indicators;
(9) public access to company briefings; and
(10) the use of digital facilities and forums to enhance corporate communication.

The remainder of this chapter discusses these issues.

§13.03 THE CLARITY, COMPLETENESS AND ACCURACY OF COMPANY INFORMATION

The objective of financial reporting is to provide information about the financial position and prospects of a company that is useful to a wide-range of users in making economic and other decisions. In practice, the quality of listed company reporting and disclosure varies greatly across the globe. As highlighted in Part III, some companies report and communicate their story and performance in a concise and effective manner, but others provide lengthy disclosures conveying little. Many national regulators provide guidance on the appropriate form, balance and tone of company reports to enhance their quality and readability. These guidance principles often draw on principles developed by the plain English movement. The plain English movement has a long history across many professional areas and jurisdictions. Its primary aim is to encourage the presentation of complex information in an orderly and clear manner so that readers have the best possible chance of understanding it.[7]

The plain English movement has significantly influenced securities disclosure regulation and practice around the globe over the last thirty years. In the 1980s, Arthur Levitt, the Chair of the SEC, promoted the publication of a plain English handbook to improve the readability and comprehension of disclosure documents. He indicated that he could not always decipher what was being said in the filed documents of public companies. He suggested a range of possible explanations for the poor quality of company disclosures, including the following:

- The reader may not have the technical knowledge to grasp what the writer wishes to convey.
- The writer may not understand what he or she is talking about.

7. See, e.g., 'The principles of plain English' at http://www.plainenglish.com.au/princi.htm; 'What is Plain Language?' at 'http://www.plainlanguage.gov/whatisPL/.

- The ill-intentioned writer does not want the reader to understand the subject but disclosure on the matter is legally required.
- The well-intentioned and informed writer fails to get the message across to an intelligent and interested reader because of stilted jargon and complex construction.[8]

The plain English handbook developed by the SEC indicates that disclosure documents must impart complex information in a way that enables investors to make informed decisions. It describes writing documents in plain English as:

> analyzing and deciding what information investors need to make informed decisions, before words, sentences, or paragraphs are considered. A plain English document uses words economically and at a level the audience can understand. Its sentence structure is tight. Its tone is welcoming and direct. Its design is visually appealing. A plain English document is easy to read and looks like it's meant to be read.[9]

Warren Buffett assisted with the production of the handbook. In the preface he suggests that disclosures should be written with a specific person in mind. He states that:

> When writing Berkshire Hathaway's annual report, I pretend that I'm talking to my sisters. I have no trouble picturing them: Though highly intelligent, they are not experts in accounting or finance. They will understand plain English, but jargon may puzzle them. My goal is simply to give them the information I would wish them to supply me if our positions were reversed. To succeed, I don't need to be Shakespeare; I must, though, have a sincere desire to inform.[10]

The most common problems the SEC identifies in disclosure documents include long sentences, passive voice, weak verbs, superfluous words, legal and financial jargon, numerous defined terms, abstract words, unnecessary details, and unreadable design and layout.[11] Its plain English initiatives have been wide-ranging, encompassing policy guidance and testing disclosures in prospectuses, mutual fund documentation, and listed company reports. The plain English disclosure testing rules require companies to write the cover page, summary and risk factors sections using short sentences, definite, concrete and everyday language, the active voice, tabular presentation of complex information, no legal or business jargon, and no double negatives.[12] Specific disclosures were tested by presenting them in various alternative formats across a

8. See United States Securities Exchange Commission, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (August 1988) Preface.
9. United States Securities and Exchange Commission, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (August 1988) 5.
10. United States Securities and Exchange Commission, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (August 1988) 2.
11. See United States Securities and Exchange Commission, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (August 1988).
12. Cynthia A Glassman, United States Securities and Exchange Commissioner, 'Does the SEC Disclosure Eschew Obfuscation? Res Ipsa Loquitor' (Speech presented at the Plain Language Associations International's Fifth International Conference, Washington DC, 4 November 2005).

number of cities. The testing confirmed that to be effective, the format and placement of information in the disclosures are as important as the content and words used.[13]

In 2005, SEC Commissioner Cynthia Glassman suggested that:

> it is clear that there is a difference in goals of the disclosing parties and the recipients of those disclosures. Very simply put, it is my perception that disclosing parties and their lawyers – be they mutual funds, broker-dealers, investment advisors, or operating companies – view their disclosure obligations with an eye toward limiting their potential liability. Thus, the disclosures that they make, while often voluminous, do not necessarily provide information in a helpful informative manner. In contrast, the recipients want timely, complete, and useful information that is readily understandable.[14]

Glassman suggested the primary goal is the provision of clear, concise and accurate information to enable sound investment decisions.[15]

In 2007, Christopher Cox, the Chairman of SEC, argued that companies can best control their litigation risk by presenting material information in plain English,[16] but conceded that making investor communication easier to read and understand is a big job and requires changing ingrained practices.[17] He noted the tendency to use legal jargon and boilerplate language and suggested this discourages investors from reading the disclosures. He indicated that clear disclosure of the key figures and facts and meaningful analysis and explanation is required. His ultimate test of effective disclosure is whether the substance and presentation of the disclosed content matter is readable and useful to its readers.[18]

Disclosure principles outlined by other national corporate and securities regulators are broadly similar to those promoted by the SEC. For instance, a recurring feature of Australian securities regulation is a legislative requirement for disclosure documents to be 'clear, concise and effective'.[19] Clear, concise and effective documentation has been described by Belinda Gibson, a prior Commissioner of ASIC, as:

13. Cynthia A Glassman, United States Securities and Exchange Commissioner, 'Does the SEC Disclosure Eschew Obfuscation? Res Ipsa Loquitor' (Speech presented at the Plain Language Associations International's Fifth International Conference, Washington DC, 4 November 2005).
14. Cynthia A Glassman, United States Securities and Exchange Commissioner, 'Does the SEC Disclosure Eschew Obfuscation? Res Ipsa Loquitor' (Speech presented at the Plain Language Associations International's Fifth International Conference, Washington DC, 4 November 2005).
15. Cynthia A Glassman, United States Securities and Exchange Commissioner, 'Does the SEC Disclosure Eschew Obfuscation? Res Ipsa Loquitor' (Speech presented at the Plain Language Associations International's Fifth International Conference, Washington DC, 4 November 2005).
16. Christopher Cox, Chairman United States Securities and Exchange, 'Plain Language and Good Business' (Speech delivered to the Center for Plain Language symposium, Washington DC, 12 October 2007).
17. Christopher Cox, Chairman United States Securities and Exchange, 'Plain Language and Good Business' (Speech delivered to the Center for Plain Language symposium, Washington DC, 12 October 2007).
18. Christopher Cox, Chairman United States Securities and Exchange, 'Plain Language and Good Business' (Speech delivered to the Center for Plain Language symposium, Washington DC, 12 October 2007).
19. *Corporations Act 2001* (Cth) ss 249L, 715A, 719, 942B, 942C, 947B, 947C, 1012C, 1013C, 1019I, 1019J.

> [d]ocuments ... [that are] readable – if they are lengthy, there must be a clear road map to enable the readers to select the information they need to make a sensible investment decision. They must be understandable. The content must be clear and relevant to the investment decision at hand. The risk must be put up front and in one place.[20]

She indicates that the key elements of the Australian disclosure regime are:

- disclosure of price-sensitive information to the market in a timely fashion;
- announcements that are not false, misleading or deceptive; and
- announcements that are clear, accurate and complete.[21]

She defines 'clear announcements' as market releases containing information that is factual and expressed in an objective and clear manner; 'complete announcements' as documents that can be read as a whole without reference to other documents to locate price-sensitive information; and 'accurate announcements' as disclosures that contain factually correct and easily understandable information, and that grant due prominence to both positive and negative information.[22] As the Kay Final Report acknowledges, useful information 'is provided when the content of the information is driven by the needs of users.'[23]

A empirical study by Lawrence found that individuals generally invest more in companies with clear and concise financial disclosures because this approach leads to improved returns.[24] This finding is important because it highlights the direct benefits for retail investors of well-written reports and disclosures, and the likely indirect benefits for corporations that communicate effectively, including improved investor confidence and trust, a diverse investor base, and lower capital costs.

§13.04 REGULARITY OF PERIODIC REPORTING[25]

The regularity of periodic reports remains a highly contentious issue in some jurisdictions. Listed companies in the US have been required to provide mandatory comprehensive quarterly reports to the SEC since 1970. Quarterly regimes have also been adopted in other markets over the last decade. For example, the Singapore Exchange

20. Belinda Gibson, 'Working In a Regulated Environment' (Speech delivered at the Law Society of Western Australia Summer School, 26 February 2010) 5.
21. Belinda Gibson, 'Disclosure And The Role of ASX and ASIC' (Speech delivered at the Listed Companies Conference, 26 March 2008) 6.
22. Belinda Gibson, 'Disclosure And The Role of ASX and ASIC' (Speech delivered at the Listed Companies Conference, 26 March 2008) 6.
    Belinda Gibson, 'Disclosure And The Role of ASX and ASIC' (Speech delivered at the Listed Companies Conference, 26 March 2008) 11–12.
23. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) 72 .
24. Alastair Lawrence, 'Individual Investors and Financial Disclosure' (2013) 56 *Journal of Accounting and Economics* 130.
25. Chapter 13 contains content that was included in a published article: Gill North, 'Listed Company Disclosure and Financial Market Transparency: Is this a Battle Worth Fighting or Merely Policy and Regulatory Mantra?' (2014) 6 *Journal of Business Law* 486.

has required quarterly reports that include financial statements since 2004,[26] and Japan introduced comprehensive quarterly reporting in 2008. Quarterly reporting proposals around the world have generally been welcomed by investors but opposed by business communities.[27] For instance, institutional investors in Europe called for comprehensive quarterly reporting in 2003,[28] but the European Parliament rejected this proposal following strong lobbying from businesses. In 2004, the European Commission (EC) opted for a compromise solution and the IMS obligations were introduced as part of the TD.[29] As a result, companies listed on the main exchanges in Europe were required to provide either quarterly reports or IMSs from 2007.[30] These IMSs included an outline of material events and transactions that had taken place during the quarter and their impact on the company's financial position, as well as a general description of the financial position and performance of the company.

As discussed in Chapter 7, the TD was reviewed in 2009 and the EC adopted successively changing positions.[31] In 2010, the EC recommended continuing IMS reporting,[32] but later reversed its position and sought to abolish the quarterly reporting obligation for all listed companies.[33] It also sought to prohibit individual countries from imposing stricter rules.[34] Both of these proposals were supported by the Kay Review Committee and the UK Government.[35]

[A] The Kay Review

The Kay Final Report recommended removal of the obligation to provide IMSs. The central argument underpinning this recommendation is that quarterly statements encourage listed companies and investors to focus unduly on short-term performance indicators. The Kay Interim Report cites an observation by the Institute of Directors that

26. Singapore Stock, *Listing Manual*, Ch. 7, 'Continuing Obligations' Rule 705, Appendix 7.2.
27. See, e.g., 'For and Against - Cost and Benefit Study Needed' (2003) 12 *Accountancy Age* 12; 'Europe Drops Quarterly Reporting' (2004) 23 *International Financial Law Review* 12; 'Quarterly Reporting System' (2008) 27 *International Financial Law Review* 8.
28. See, e.g., Chartered Financial Analysts Institute, *European Investment Professionals Back Quarterly Reporting* (20 November 2003).
29. European Commission (2004) Directive 2004/109/EC of the European Parliament and of the Council, Official Journal of the European Union, L 390.
30. The Transparency Directive was required to be transposed into national law by January 2007. Delays in implementation meant it was not adopted in some countries until 2009.
31. For a detailed outline of these processes, see Benedikt Link, 'The Struggle for a Common Interim Reporting Frequency Regime in Europe' (2012) 9 *Accounting In Europe* 191.
32. See European Commission, *Report from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions* (27 May 2010a).
33. European Commission, *Proposal for a Directive of the European Parliament and the European Council* amending Directive 2004/109/E, (25 October 2011) http://ec.europa.eu/internal_market/securities/docs/transparency/modifying-proposal/20111025-provisional-proposal_en.pdf.
34. Securities exchanges in Germany and Austria previously required companies listed in their prime segment to provide quarterly reports. Sweden, Finland, Greece and Portugal also required quarterly reporting prior to the amendments to the Transparency Directive.
35. Department for Business Innovation & Skill United Kingdom, *Ensuring Equity Markets Support Long Term Growth: The Government Response to the Kay Review* (November 2012) 6.

'quoted companies can be subject to short termist pressure from equity markets. This may arise due to fluctuation in share prices or as a result of pressure from sell-side analysts or activist investors (e.g., hedge funds).'[36] The Kay Final Report highlights the short-term focus of financial markets. It recommends that companies should disengage from management of short-term earnings expectations.[37] Further, it suggests that frequent reporting of financial performance encourages investors to adopt a short-term focus.[38]

The argument that quarterly reporting leads to a greater focus by investors on short-term factors and that it encourages short-term earnings management presumes there are significant correlations or relationships between the following:

(1) the preparation and release of quarterly reports (or IMSs);
(2) a general investor focus on short-term factors; and
(3) short-term earnings management by listed company executives.

However, the Kay Final Report does not discuss these connections. Most critically, it does not explain how the removal of quarterly reporting (or the IMS obligations) will simultaneously alter short-term pressures from market participants (such as sell-side analysts and hedge funds) and executive engagement in short-term earnings management. Any links or correlations between quarterly reporting, short-termism and management of short-term earnings expectations are instead assumed. The Kay Final Report acknowledges that analysts predict likely earnings results and companies engage in this process by providing explicit or implied earnings guidance, but it does not include any concrete proposals to alter these entrenched patterns beyond removal of the IMS obligations.[39] Regardless of the length of the reporting period, sell-side analysts will continue to publish research reports with near term company earnings estimates and security price targets, and many listed companies will continue to seek to align these sell-side analyst forecasts with internal company forecasts. The Kay Final Report does not discuss the motivations driving, or resolve the conflicts involved with, short-term earnings management. Company boards and managers are not obliged to, and should not in fact, adjust their strategies or management because they report quarterly. Managerial concerns with meeting short-term earnings expectations encourage misconduct, absorb considerable scarce resources without producing any corresponding benefits for the company, and are potentially costly over long horizons.[40]

36. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Interim Report* (February 2012) 8.
37. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) 13.
38. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) 10.
39. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) 64.
40. See, e.g., Lynne Dallas, 'Short-Termism, the Financial Crisis, and Corporate Governance' (2012) 37 *Journal of Corporation Law* 265, 278–279.

The Kay Interim Report states that the general principle that 'more information is better has driven regulation of both corporate governance and securities markets in the past, and continues to do so.'[41] The Kay Final Report highlights the broad consensus among respondents that too much data (bad or useless information) is being produced and not enough information.[42] It links the provision of large quantities of data, which it asserts is of little value to users, to an exaggerated faith in Fama's efficient market hypothesis.[43] It extends this argument to a claim that providing mass data may drive 'damaging short-term decisions by investors, aggravated by well-documented cognitive biases.'[44] These comments infer that most irrational or biased trading and behaviour in equity markets is driven by the receipt of copious data. The report does not provide specific examples or evidence to support these comments, so it is unclear what the report authors consider constitutes 'copious data' and whether this is data provided by companies or financial intermediaries. The Kay report authors may consider that IMSs provide copious or useless data.[45] It is doubtful though that investors and stakeholders without ongoing private access to company executives would agree with this stance. In any event, IMSs typically provide summary high-level commentary on trading conditions, without the support of financial statements, so they provide minimal grist for persons focused on short-term numbers.

The Kay Final Report suggests the type of information contained in IMSs should be 'disclosed in negotiations between asset managers and companies'.[46] However, company directors and managers and asset managers are subject to the same personal failings and cognitive biases as everyone else and this recommendation ignores the issues and conflicts of interest that arise from discretionary private relationships between company managers and favoured investors. Institutional demands for private meetings with executives and for continuing updates on a company's performance and prospects could be expected to accelerate in the wake of the TD reforms. Further, the segments of the market that are most focused on short-term trading and near horizon

41. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Interim Report* (February 2012) 21.
42. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Interim Report* (February 2012) 21–22. It would be interesting to know the characteristics of the respondents that indicated during the consultations processes that too much data is being produced.
43. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) 10.
44. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) 10.
45. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Interim Report* (February 2012) 21–22. An outline of the type of participants that gave these responses and an explanation of the reasons why the information in interim management statements is useless would be helpful to progress the debate.
46. *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) 74. If the basis on which asset managers and company managers are intended to 'negotiate' refers to bidding arrangements, this accords with current practices in the UK. The Financial Times in the UK reported in 2013 that asset managers were paying large sums of money to brokers and investment bankers for arranging meetings with chief executive officers. Analysis by the Financial Services Authority (FSA) found some large asset managers were making these payments using client commissions: Steve Johnson, 'FSA Crackdown on Cash For CEO Access', *FT.com*, 4 March 2013.

national regulators, as well as recommendations drawing on this author's many years of experience analysing company disclosures across major financial markets. The best practice company disclosure framework is discussed within two sections: regulatory structures and disclosure conduct.

Chapter 16 provides a concise summary of the book's arguments and concludes.

CHAPTER 15

Best Practice Company Disclosure Frameworks

> Regulators, under unprecedented pressure, face a range of demands, often contradictory in nature: be less intrusive – but more effective; be kindlier and gentler – but don't let the bastards get away with anything; focus your efforts – but be consistent; process things quicker – and be more careful next time; deal with important issues – but don't stray outside your statutory authority; be more responsive to the regulated community – but don't get captured by industry.[1]

§15.01 BEST PRACTICE COMPANY DISCLOSURE: REGULATORY STRUCTURES

[A] Regulator Transparency

A culture of public communication, transparency and accountability should start at the top of the disclosure regulatory hierarchy. All regulators of disclosure matters should be as open and continuously engaged with their various stakeholders (including the general public) as possible. Security exchanges and taxpayer-funded regulators must ensure that their supervisory and enforcement operations appear to be, and indeed are, fair, consistent and transparent. In the modern era, this requires websites that are user friendly and functional, with search engines that enable people to find relevant information quickly. The roles and powers should be clearly explained on the websites of the national regulators and security exchanges, including the allocation of responsibilities and the nature of the relationships between the exchanges and regulators. The rules, supervisory processes, and enforcement powers relating to disclosure matters should be outlined, and the details of any enforcement actions should be readily accessible. For example, the HKSE and JPX provide details of disclosure related processes and disciplinary proceedings on their websites. The SEC also provides

1. Malcolm Sparrow, *The Regulatory Craft* (Brookings Institution Press, Washington DC, 2000) 17.

disclosure guidance and outlines its enforcement actions across the various disclosure regimes. These digital processes raise awareness of disclosure issues and promote better disclosure standards for minimal cost.

The capacity and ability of regulators to supervise company disclosure regimes, and to successfully initiate enforcement actions when required, are essential ingredients of effective disclosure frameworks. Nevertheless, the efficacy of company disclosure regulators should not be assessed solely or predominantly on the number of successful enforcement outcomes. The absolute number of such actions is limited given typical resource constraints. Moreover, the disclosure events that can be pursued by regulators, particularly those involving more severe forms of enforcement such as litigation, generally reflect the most egregious conduct rather than common practice. The main focus of all disclosure regulators should be to promote a positive culture of public disclosure across entire markets by emphasising the long-term benefits of effective corporate communication that build and sustain a reputation of reliability, transparency and trust. Building and nurturing such disclosure cultures should be a high priority for all regulators, and all available tools should be harnessed to achieve this objective. For example, the SEC supervisory processes are broadly transparent. Publication of queries to listed companies and the company responses provides a good example of a relatively low cost procedure that alerts companies and others to potential disclosure issues.

A publicly funded central facility that provides easy access to national company periodic reports and continuous disclosure is important. The EDGAR website run by the SEC in the US is a good model for other jurisdictions to consider. Similar facilities that provide details on open access webcasts by listed companies should also be established to promote greater transparency and equity in relation to company briefings. These combined facilities would greatly assist investors to make well-informed and timely decisions and manage their company security holdings within savings and retirement portfolios. These facilities would also provide an independent record of companies embracing digital technologies to provide public access to substantive high quality information on a timely and consistent basis.

Most of the leading global exchanges operate tiered markets, with a main market for larger, more established companies, and additional secondary markets for smaller or growth companies. The listing requirements and ongoing obligations are generally less onerous for companies listed on the lower tier markets, because these markets are intended to provide flexible capital raisings and securities trading mechanisms for developing companies. The FSE uses a different model that other exchanges might consider implementing to enhance market transparency and company disclosure standards. It operates a single market, but companies can choose the listing standard with which they wish to adhere. Companies may list on the FSE under the general listing category with disclosure obligations that merely comply with EC standards, or may choose the premium listing category with higher disclosure standards, in the expectation that this provides long-term reputational and valuation benefits. This voluntary disclosure structure allows savers to invest in companies with their preferred disclosure standard and associated risk. Companies with the highest disclosure standards are – all other things being equal – likely to attract a premium rating and

valuation, and this competitive process motivates other companies to opt for the higher disclosure standards. Hence this structure promotes better public disclosure practices as a positive feature of listing that ultimately benefits corporations and their investors and stakeholders.

[B] Regulatory Priorities

There has been a renewed focus over the last decade by most national regulators on enforcement of insider trading. For example, the FSA 2013 annual report states that '[o]ver the last 12 months the FSA conducted four criminal trials, prosecuting more individuals for insider trading this year than any other.'[2] Similarly a paper that discusses market cleanliness in the UK states that there were no convictions for insider trading in the years from 2004 to 2008, but twenty-three convictions during the period from 2009 to 2013.[3] The FSA was criticised by the House of Commons Treasury Committee and by various government reports for its 'light touch' regulatory approach following the GFC.[4] Alexander suggests that a tougher approach has since been taken by regulators that 'aims to expose and deter market abuse which has been rife in UK financial markets for many years' including the transfer of inside information.[5]

An increasing emphasis by regulators on insider trading may be misconceived, because it changes the supervisory and disclosure cultures and frameworks in a subtle but profoundly important way. Continuous disclosure regimes are related to, but distinct from, insider trading rules. The nature of insider trading regulation is negative, reactive, and narrowly focused, while continuous disclosure frameworks are positive, proactive and broad in nature. Insider trading regulation can only be applied after the relevant event, when any investor losses or shifts in wealth have already occurred. Insider trading litigation is broadly analogous to sending in the ambulance when disclosure accidents have occurred. These disclosure accidents include failures to periodically or continuously disclose material information, or incidents of selective disclosure of information to some investors or segments of the market. National regulators are limited in the number and type of court actions they can initiate, because litigation is risky, expensive and time-consuming. Large scale insider trading cases can take many years, and the final decisions are often delivered well after the relevant events. Furthermore, insider trading enforcement actions are generally motivated by deterrence rather than compensation. Favourable insider trading judgments typically do not provide compensation to investors and stakeholders who have suffered losses.

2. Financial Services Authority, *FSA Annual Report 2012/2013* 39.
3. Jim Goldman, Stefan Hunt, Paul Minter, Felix Suntheim and Qamar Zaman, 'Why Has the FCAs Market Cleanliness Statistic for Takeover Announcements Decreased Since 2009?' *Financial Conduct Authority Occasional Paper No. 4* (July 2014).
4. See, e.g., Kern Alexander, 'UK Insider Dealing and Market Abuse Law: Strengthening Regulatory Law to Combat Market Misconduct' in Stephen Bainbridge (ed.), *Research Handbook on Insider Trading* (Edward Elgar, Cheltenham UK, 2013) 424.
5. See, e.g., Kern Alexander, 'UK Insider Dealing and Market Abuse Law: Strengthening Regulatory Law to Combat Market Misconduct' in Stephen Bainbridge (ed.), *Research Handbook on Insider Trading* (Edward Elgar, Cheltenham UK, 2013) 424.

Recoveries realised by investors and taxpayer-funded regulators are often minimal in comparison to the amounts of wealth that are transferred on a day-to-day basis when insider trading events occur.

National company and securities regulators funded by taxpayers have limited funds, so they need to establish clear priorities and strategies. Best practice regulatory frameworks must ensure that available resources (including manpower, skills, knowledge and financial resources) are allocated as efficiently as possible to achieve regulatory objectives. As discussed more fully in the next chapter, the most efficient way to minimise most forms of market abuse and the level of insider trading across the market is to promote, monitor and enforce the existing periodic and continuous disclosure regulation that requires public disclosure of company information on a regular, comprehensive and timely basis. Assuming the FSA 2013 annual report and the FCA 2014 annual report fairly reflect the regulatory priorities in the UK, the quality and timeliness of listed company disclosure are not high on the agenda.[6] The disclosure priorities and allocation of regulatory resources in some of the jurisdictions reviewed may therefore require some recalibration, with a shift of resources to enable more intense supervision and enforcement of company disclosure frameworks. While best practice regulatory structures should include misconduct litigation such as insider trading, all company and securities regulators should prioritise and emphasise compliance with, and enforcement of, periodic and continuous disclosure obligations. Multifaceted regulatory approaches that vigorously promote a culture of high quality disclosure are likely to achieve disclosure policy goals and minimise losses suffered by investors and others more effectively than a dominant reliance on insider trading litigation. Scarce resources (particularly taxpayer monies) are better spent on programmes that proactively encourage high quality disclosure practices and prevent disclosure accidents from happening in the first place.

[C] Regulatory Review Programmes

National regulators outside of the US have used various approaches to enhance the quality of company disclosures. A common theme of these endeavours is an emphasis on corporate reporting that presents information in a clear, concise and effective manner. This process has been assisted by the plain English movement, which promotes documents that are written and expressed in such a way that readers can readily understand them. Policy guidance urging the use of clear, concise and effective disclosure is important, but without more, is unlikely to drive significantly improved company disclosure cultures and practices. Within best practice company disclosure regulatory structures, policy guidance should be supplemented by substantive regulatory initiatives. For example, regular reviews of publicly available company reports and disclosures by independent bodies are an essential feature of a best practice

6. The annual reports do not contain any discussion of listed company disclosure related matters, other than to highlight a positive trend in commissioned market cleanliness studies that examine possible suspicious trading in the two days prior to announcements of mergers and acquisition transactions. These studies are explained in Ch. 14.

disclosure framework. These review programmes should be multilayered and should include proactive monitoring and a broad range of supervisory functions, including education, policy guidance, and published discussions of identified risks and issues.

The corporate disclosure review programmes in Canada discussed in Chapter 6 provide a sound model for other jurisdictions to consider because the review processes operate as a virtuous cycle that promotes enhanced public reporting. These review programmes include full and targeted reviews of disclosures. The survey methodologies use a risk-based filter and quantitative and qualitative criteria. The review category outcomes are clearly specified and consistently applied. The programme sampling and outcome methodologies, the layout and content of the review reports, and the guidance and disclosure principles are consistent from year to year, providing clear disclosure policy standards and feedback. The review reports document the disclosure outcomes and discuss disclosure deficiencies in detail, providing an independent public record of progress achieved. They also highlight recurring problems and difficult issues for policy and scholarly consideration.

The Canadian disclosure review programmes include proactive measures such as early discussion with companies identified as potentially at risk of breaching the disclosure rules, with subsequent reviews of their filings. The regulatory responses are flexible, targeted and proportionate when non-compliance is uncovered. Enforcement actions are initiated using an extensive armoury of options and processes. When minor issues arise, companies are asked to make changes to disclosures in upcoming filings. When disclosure deficiencies are sufficiently significant to require refiling, the company's name, the date of refiling, a description of the disclosure deficiencies and the press release incorporating the revisions are posted on the regulatory website for three years. These postings highlight consistent offenders in the public arena and thereby operate as a 'name and shame' deterrent. Only the most serious deficiencies are referred to the enforcement area for action, reducing the required level of regulatory resources dedicated to litigation.

As discussed in Chapter 10, the HKEC also reviews company reports and disclosures on an annual basis. Its processes share some of the features of the Canadian programmes, with additional positive elements. The companies reviewed are selected using a risk-based approach that includes impact and probability criteria. The HKEC also selects a general accounting theme and an industry theme to examine each year. The accounting themes it has reviewed include business combinations and investments in associates and joint ventures, accounting for financial instruments, segment disclosure, accounting for goodwill and intangible assets, and accounting for impairment of assets. The industry themes reviewed include toll road infrastructure projects, companies with a major or principal business of mining activities, companies with a major or principal business involving property construction or investment in properties, businesses involved in telecommunications and internet services, and companies whose major or principal businesses are power and utilities.

The HKEC publishes an annual review report that identifies and discusses accounting and specialist industry disclosure issues. All of the HKEC reports note that some companies repeat information from the financial statements in narrative form within the MD&A sections, without further explanation or analysis. They repeatedly

highlight that companies with substantial fluctuations in turnover, operating results, net asset values and segment results often provide little explanation or discussion. They recommend that companies expand their MD&A to explain how the reported and prospective financial positions, liquidity and operations have been, or will be, affected. They call for discussion in the MD&A to be consistent with the financial statements, and for outlines to improve readers' understanding of the nature and impact of significant events and material balances and transactions. They also emphasise that financial information prepared in accordance with accounting standards is the most important section of the financial reports.[7]

General corporate disclosure reviews can be enhanced by specialist or targeted surveys. For example, the OSC examined disclosures containing forward-looking information in 2012 in recognition of the critical importance of this type of information to investors.[8] Its report notes that only a third of companies reviewed provided a comparison of actual results with previously disclosed guidance. It identifies four areas for improvement:

(1) clear identification of forward-looking information;
(2) disclosure of the underlying material factors or assumptions;
(3) updates to forward-looking information; and
(4) discussion of actual results following disclosure of forward-looking information or estimates.[9]

To assist companies, the OSC report provides specific examples of boilerplate disclosure and preferred entity-specific disclosure. More generally, it recommends timely updating of earnings guidance following changes in managerial expectations. It also encourages the use of financial and non-financial key performance indicators. It suggests that companies present forward-looking information in reports in a separate section, including a table that sets out the company's objectives, specific assumptions and risks.[10] These recommendations reflect best practice.

National and global regulators accumulate extensive knowledge and experience about superior corporate disclosure techniques, form, and content. This knowledge should be systemically documented and communicated in the form of detailed and published feedback. Otherwise, the benefits of comprehensive monitoring are likely to dissipate over time. Regular and systematic empirical reviews of company reports and disclosures, such as those published by the CSA and HKEC, provide an invaluable independent record of company disclosure developments and issues. Such programmes are likely to promote and sustain high quality disclosure standards at a

7. Hong Kong Exchanges and Clearing Limited, *Financial Statements Review Programme Report 2012* (January 2013) 29.
8. Ontario Securities Commission (OSC), *Forward-Looking Information Disclosure* (OSC Staff Notice 51-721) 4, 7.
9. Ontario Securities Commission (OSC), *Forward-Looking Information Disclosure* (OSC Staff Notice 51-721) 3.
10. Ontario Securities Commission (OSC), *Forward-Looking Information Disclosure* (OSC Staff Notice 51-721) 20.

relatively minimal cost, particularly when supported by carefully calibrated supervisory and enforcement structures.

§15.02 BEST PRACTICE COMPANY DISCLOSURE: DISCLOSURE CONDUCT

[A] Disclosure Conduct: Periodic Reporting

This author's examination of disclosures found similar issues to those highlighted in the regulator review reports outlined in Part III, including poorly written MD&A, commentary referencing non-compliant financial measures, and a lack of comprehensive and specific risk disclosures. The examination also identified significant issues with the full year reporting processes, long-term performance commentary and analysis, and reporting formats that hinder, rather than promote, comparative analysis. The ensuing discussion discusses best practice mechanisms and conduct to address these issues.

[B] MD&A

Corporate directors and managers need sharply focused strategies and well implemented plans to remain competitive and achieve optimal performance, especially during challenging periods. There are significant benefits for managers and their stakeholders when corporate reporting is presented in a clear and consistent manner. Well-written commentary on important items and trends, combined with transparent and frank strategic and performance analysis, conveys a message to readers that the senior executives understand the status and position of the company, and its immediate and longer-term challenges. Clear disclosure and communication of company strategies and plans improves market confidence, encourages ongoing investment, and promotes and builds stakeholder trust and confidence.

The US has acknowledged the importance of high quality MD&A in company periodic reports for many decades. The MD&A in the full year reports in the US must address segmental performance, industry and economic factors affecting the company performance, the drivers of the changes in financial conditions or results, and the effects of discontinued operations. The reports must also discuss the income statement, including commentary on cost of sales, changes in the gross and net margins, contribution by business segment, capital commitments, risks and uncertainties, inflationary impacts, use of working capital, and unusual or infrequent events or transactions. The MD&A must include analysis of the company's balance sheet, including the end of period positions and ongoing drivers of liquidity, capital resources, off-balance sheet arrangements, transactions with related parties, proposed transactions, critical accounting estimates, and financial instrument exposures. The mandated MD&A in the quarterly reports, while more limited than in the full year reports, requires analysis of the quarter and year-to-date operations and cash flows, changes in results not related to ongoing business operations, and seasonal aspects affecting the

results, operations or cash flow. These MD&A categories provide necessary contextual information for company managers and directors, and for outsiders, to interpret the financial statements and better understand the company's environment and its position and prospects.

Discussion and analysis of a company's historical and expected financial performance and operations within all periodic reports should include, at a minimum, the following information:

- an outline of the company's strategies, objectives and key performance indicators;
- MD&A of the company's performance against the stated criteria during the reporting period;
- the causes of material changes to line items of the financial statements;
- segmental information and analysis;
- disclosure of significant factors and events, including unusual events, non-recurring items and new developments;
- information concerning the company's liquidity and its ongoing ability to generate sustainable positive cash flows;
- foreign currency and translation effects;
- discussion and analysis of material trends, uncertainties and risks;
- commentary and analysis on longer-term trends and performance;
- forward-looking commentary and guidance; and
- commentary on the broader environment in which the company operates, including macroeconomic factors, industry trends and issues, sustainability issues, and relevant policy developments.

Best practice company reports provide MD&A and financial notes that are balanced and proportionate, with the level of detail reflecting the materiality or significance of the item, matter, or area discussed. Such reports frame the MD&A around the financial statements, with detailed notes and explanation of the reported numbers in the income statement, balance sheet, and cash flow statement. As regulatory reviews note repeatedly, period-to-period movement should be presented in numerical form, leaving scope within the commentary to explain or analyse the changes. Detailed analysis is then provided of important components that led to the result, including revenue and expense items, and business segment and product contributions. Key items on the balance sheet and cash flow statement are explained, including the debt, cash and liquidity positions and tables showing the scale and maturity profiles of significant debt items and capital commitments. The general commentary sections include discussion of company strategies within a broader context, including business and industry trends and seasonal factors.

Listed companies should publicly release all of the information that investors and other stakeholders need to value a company's securities, monitor its developments, and assess its financial and social performances. The nature and scope of additional information required for this purpose may vary by company and sector. Specialist sectors should provide sufficient information to enable all outsiders to assess their

performance. For example, financial group reports should include clear capital outlines, detailed risk management plans and processes, and extensive data tables encompassing loan books, loan types, provisioning, margins, credit growth, domestic and country exposures, derivative positions, market share trends, and credit ratings. Similarly, resource company reports should include definition sections, five year historical production tables (including the volume and value of the primary products, as well as targeted and expected production volumes), average commodity prices and exchange rates for the period, clear summaries of the historical and forward derivative positions, detailed project and risk outlines and assessments, and sensitivity tables and analysis showing the historical and expected future relationships between commodity volume, price and exchange rate movements and financial outcomes. It is especially critical for resource companies to provide long-term performance reporting, including specific financial, social responsibility and sustainability goals, metrics and outcomes, given the typical length of resource and resource project cycles. The overarching principle that should motivate the content of MD&A in periodic reports and continuous disclosures should be communication that enables timely and well-informed decision making.

[C] Reporting in Compliance with Accounting Standards

Most jurisdictions have enacted some rules that prohibit or limit the use of non-compliant financial measures. Some countries require companies to provide tables that reconcile the non-compliant financial measures to the reported figures and an outline of the calculation methodologies. Some jurisdictions require companies to explain why the adopted non-compliant financial measures are useful. Some also require companies to provide warnings that these measures may not be comparable to similarly named financial measures used by other companies. These various rules are important and should be consistently applied and enforced. Some listed companies reference the same non-compliant financial measures and performance indicators over long periods and clearly explain the calculation methodologies and reasons for using these measures. Others provide this information in a separate explanatory appendix or as outlines on the company website. These practices are commendable, but are not universal. The empirical reviews outlined in Part III consistently highlighted issues concerning the use of unexplained references to non-compliant financial measures and the provision of management commentary with minimal, if any, connection to the financial statements.

Given the growing scale and adverse impact of issues involving the use of non-compliant financial measures, stricter regulatory protocols may be required. Best practice company disclosure frameworks should provide financial information and MD&A using consistent financial measures and terminology that is well-understood, integrated, and consistent across time and markets. This may require company disclosure that consistently reports and references financial measures calculated in