Developments in New Zealand's Securities Market Regulatory Framework

Professor Keitha Dunstan
Member - New Zealand Securities Commission
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I welcome the opportunity to be here on behalf of Jane Diplock and the New Zealand Securities Commission. My topic is a broad one – developments in the New Zealand regulatory framework. Let me focus on four developments in particular, and then reflect on the underlying drivers for reform over the past decade.

Legislative Reforms

We should start, of course, with the legislative package currently before the New Zealand Parliament and due for final passage very soon. The Securities Legislation Bill will reform and tighten the law on insider trading and fill regulatory gaps that have become apparent over recent years. This is a major piece of legislation, which has taken almost two years in the Parliamentary process so far. The Securities Commission has been very supportive of the Bill, because of its importance in bringing New Zealand more fully into the international mainstream of regulatory law and practice – a theme which I will cover later.

Insider trading is a serious issue across the Tasman, as in every other market around the world. The Bill marks a fundamental departure from the existing 1988 legislation under which insider trading is treated primarily as a wrong against the company concerned and its shareholders. The existing law puts an emphasis on information ownership and on the share trading of people closely connected to a company. In the Bill, insider trading is recognised as behavior which is damaging not just to individual companies and shareholders, but also to the efficiency and integrity of the securities market overall. As such, any trading on non-public price sensitive information will be outlawed – not only where the information is directly sourced from the company or its directors and employees. The Commission will be able to seek civil penalties to enforce this law, and criminal sanctions will also be available.

The Securities Legislation Bill also introduces a new regime for dealing with market manipulation – conduct that interferes with the free and fair operation of markets. In this area, the legislation is filling a significant gap in the New Zealand framework as it now stands. There will be a prohibition on false or misleading statements with regard to listed securities, and general provisions for dealing with misconduct in relation to any securities issuance and trading. The Bill gives the Commission new powers to act against anyone manipulating the market, while the Courts will be able to impose hefty civil penalties and, in some circumstances, enter criminal convictions and impose prison sentences.

The Bill addresses a critical area in which New Zealand has, again, been seen to lag behind international practice – the regulation of investment advisers. Advisers will be subject to new disclosure requirements backed by new enforcement powers for the Commission. The Commission will be able to ban misleading, confusing or deceptive advertisements, and to generally enforce compliance with the disclosure requirements. Beyond disclosure, the Bill also ventures into conduct regulation, with a prohibition on advisers and brokers recommending illegal investment offers. I might add that this is something welcomed by the Commission: we have been very disquieted by some of the behaviour of advisers in the recent past.

There are further substantive developments to follow in the regulation of advisers and other financial intermediaries. The Government has in principle accepted recommendations from a Task Force on the Regulation of Financial Intermediaries, set up in 2005 to look at this whole area, and is currently consulting publicly on proposals for reform. Under these proposals New Zealand will move to a co-regulatory framework under which approved professional bodies will set comprehensive standards for intermediaries, and will monitor performance against these standards, with oversight from the Commission. These reforms will build on elements in the current Bill and establish a comprehensive framework for financial intermediaries which, as I say, will be much welcomed.

This will be the next step in a series of reforms that include the current Bill and which date back to 2000, when New Zealand began a major shift in direction on securities law -- and I will talk more broadly on that later. In 2000, New Zealand adopted a Takeovers Code similar to those in Australia and other jurisdictions. Its introduction was followed in 2002 by a major reform package known as the Securities Markets and Institutions Bill. This gave statutory force to Continuous Disclosure rules for companies listed on the New Zealand Stock Exchange, and introduced new requirements for the disclosure of directors' trading in securities. The 2002 legislation gave the Commission significant new responsibilities and powers. Among these are the ability to accept undertakings from issuers who agree to rectify breaches of securities law, and the power to take court action and seek civil remedies in cases of insider trading. Prior to this, only companies or their shareholders could initiate insider trading actions – something that has proved a severe limitation on New Zealand's ability to curb such behavior.

The 2002 legislation clarified the role of the New Zealand Stock Exchange as a regulator following its demutualization in that year. Thereafter, the Commission had a role to carry out oversight of the new exchange company, NZX Limited. The Commission is currently completing its first review of its performance as a first-line regulator. This brings me to the next of my four key developments: the Commission's expanding role.

Securities Commission

The Commission has been New Zealand's lead securities market regulator since 1978. Today it is classified as an Independent Crown Entity, charged with promoting market efficiency and integrity as a basis for growth in capital investment in the country. Jane

Diplock has recently been appointed for a second five-year term as Chairman. The Commission has nine other, part-time members. Each is appointed for their professional knowledge and experience in industry, commerce, economics, law, accountancy or securities. Legislative reforms are expanding the Commission's responsibilities and powers and, under Jane's leadership, it has an increasingly assertive role in the New Zealand market and also among securities regulators worldwide.

The 2002 legislation gave the Commission increased powers of inspection, and enhanced powers to summon witnesses and require them to answer questions. In addition, the Commission gained the power to accept enforceable undertakings by securities issuers and others who agree to rectify their breaches of securities law. This has proved a very effective mechanism for securing legal compliance without the costs and delays of court action. In the latest year, ended on 30 June, the Commission accepted five enforceable undertakings from companies and individuals.

The Commission has made vigorous use also of the 2002 changes in insider trading law. Indeed, the latest year brought excellent progress on Commission-initiated court actions against shareholders in two prominent companies. The Tranz Rail case has been a particularly significant milestone. In this case, proceedings were filed against six former shareholders seeking compensation and pecuniary damages for losses avoided through the selling of shares in the-then national railway operator during the first half of 2002. Our proceedings alleged that the sellers took advantage of inside information on, among other things, Tranz Rail's forecast financial performance, asset writedowns and creditworthiness. The Commission went to considerable lengths in New Zealand and internationally to obtain documents and other evidence. And to date, four of the six defendants have settled with the Commission. In the most recent, last March, a former director and an institutional investor agreed to pay, without admission of liability, the full compensatory amount sought – more than NZ$7 million. They also made a full contribution to the Commission's costs. This particular insider trading action is still live against the remaining defendants so further comment is not appropriate. Nonetheless, the outcome to date is clearly another sign of the Commission's growing maturity and effectiveness in the New Zealand market.

That is evident in other areas as well. Three years ago, the Commission took the lead in framing corporate governance principles to apply to listed companies and a range of other economically important entities in New Zealand. Through a review of codes and laws internationally, and extensive consultation with local directors and businesses, the Commission formulated nine core Principles of corporate governance. They are not dissimilar to the principles and guidelines of the ASX Corporate Governance Council, and they have been widely adopted in New Zealand. The consultation revealed that a principles-based approach, rather than a rules-based approach was preferred. The Commission recognised the need to establish a framework for governance that would be practical and relevant to different forms of organisation, and their shareholders and stakeholders. The Commission now has a clear set of benchmarks for monitoring, and commenting on, governance practices and reporting in New Zealand.

The Commission takes its role in the surveillance of issuers and of market trends very seriously. This includes being particularly active over the past two years on the disclosure practices of finance companies – a sector in which instability has since become a topical issue for New Zealand's investing public. In the wider corporate sector, the Commission is now into the third year of a Financial Reporting Surveillance Programme which looks systematically at the financial reports, prospectuses and other disclosures of various issuers. The level of compliance with reporting standards and with other elements of generally accepted accounting practice is assessed and specialist staff also take a view on the overall quality of reporting by issuers.

It is an extremely worthwhile exercise, leading in some cases to the Commission asking particular companies to improve their reporting. The Commission does not shrink from publicly challenging poor performance on disclosure or market behavior when that is the best course – the insider trading actions have driven that point home. However in many cases, a direct approach to the issuer concerned brings the best result for all concerned. The response from issuers has been pleasing in that they are willing to make changes and to generally improve the standard of their reporting. In the current cycle of financial reporting reviews, the Commission is looking at issuers who have adopted New Zealand equivalents to International Financial Reporting Standards – and that brings me to the next key development in our regulatory framework.

New Zealand IFRS

As most will know, all reporting entities in New Zealand must comply with IFRS equivalents for accounting periods that start on or after 1 January 2007. Our Accounting Standards Review Board approved the core platform of New Zealand equivalents in 2004, and there were some early adopters last year. The ongoing development of IFRS equivalents and of New Zealand-specific Financial Reporting Standards is carried out by the profession's Financial Reporting Standards Board. The Board has been constituted by the New Zealand Institute of Chartered Accountants.

The transition to IFRS is obviously critical in New Zealand's quest to be within the international mainstream on market regulation. Compliance with best international practices in accounting and reporting is a "must" for the credibility of our companies and for investor confidence in New Zealand. I might add that the Commission is the first public sector entity to adopt the IFRS equivalents, in its recently released accounts for the 2005-06 year. The Commission wanted to give a lead in early adoption given that it is prompting others in same direction and giving regular input to the Financial Reporting Standards Board. As international standards continue to develop, it is pleasing to see the New Zealand standards-setting community engage internationally – and of course this starts by engaging with Australia. The Trans-Tasman Accounting Standards Advisory Group is well established and doing good work

Trans-Tasman Relationship

I turn to the trans-Tasman relationship more broadly because it represents the fourth key development in the New Zealand framework for securities regulation. Our two countries have been working on business law coordination directly for the past six years – and coordination in market regulation is obviously integral to this. Much of the progress has been at a working level between the Australian Securities and InvestmentsCommission and the New Zealand Commission, the counterpart agencies. Our relationship has become very close and mutually beneficial through information sharing, staff exchanges and joint activity in multilateral forums. The two commissions meet at least twice a year.

These activities help pave the way for trans-Tasman coordination of regulatory structures. Most notable this year has been formal agreement between the two Governments to legislate for mutual recognition of prospectuses on both sides of the Tasman. With implementation in 2007, it is expected that issuers will require, in most cases, just one prospectus to offer securities in both countries. I have already mentioned the joint work stream on financial reporting standards. In fact, Australia and New Zealand have formally agreed to work towards consistency in their respective standards setting arrangements and towards continued trans-Tasman convergence of the standards themselves.

Other developments in future are likely to include mutual recognition in the regulation of financial intermediaries, including some mechanism for mutual disqualification of individuals who transgress standards in one country or the other. New Zealand probably has more headway to make on its own regulation of intermediaries before it is ready for such trans-Tasman coordination. Clearly, the various moves towards coordination made to date, or coming in the future, have been assisted by New Zealand's regulatory reforms since 2000 and also by the expanding role of the Securities Commission.

International Drivers

Of course, there are strong influences worldwide and I want to identify two in particular that are driving regulatory developments in New Zealand, and in fact, they are also driving the trans-Tasman developments just discussed. The world is moving to higher standards and greater consistency in securities regulation – a bold statement but one that is justified by the work of IOSCO, the International Organisation of Securities Commissions. For those not aware, IOSCO is a body equivalent in purpose and standing to the Basel Committee on Banking Supervision and to the International Association of Insurance Supervisors ("the IAIS"). These three, along with the International Accounting Standards Board, make up the global community of standards setters for capital and financial markets everywhere. Their shared focus is formalized in various ways including membership, alongside central banks and the international financial institutions, in the Financial Stability Forum – a body that brings together all interests in the stability of the world economy at the highest level.

The standing of IOSCO reflects its extremely broad representation – some 184 regulatory and other agencies are members, together covering around 90% of the world's securities markets. Its standing also represents the quality and pace of the body's standards setting on matters of common concern to regulators. IOSCO has established 30 core Principles for regulation in every market and delivered more specific standards, codes and commentaries for the practical guidance of agencies on many critical issues.

Like ASIC, the New Zealand Commission is a member of IOSCO's Executive Committee. Our Chairman, Jane Diplock has been the Chair of that committee since mid 2004. Indeed, Jane is a driving force in the progress made by this world body and in the spread of consistently high standards for securities regulation. Little surprise then, that New Zealand has embraced those standards and placed itself firmly in the international mainstream. Individuals aside, there is a structural shift underway in regulation worldwide with an increasingly shared view on the responsibilities and powers of regulators and on the rules that should apply to market disclosure and behavior. Such convergence comes, one might surmise, from the globalization of capital markets and the wake-up call provided to the world's most powerful regulators by Enron, Parmalat and the other high profile corporate collapses of recent years. There is a parallel international shift occurring in accounting and reporting as reflected by the adoption of IFRS in more jurisdictions.

Cross-border Cooperation

The shift to international standards brings a particular imperative for countries to cooperate in combating cross-border financial fraud and other forms of market wrong doing. It has been one of IOSCO's main achievements in recent years to negotiate and adopt a multilateral memorandum of understanding for such cooperation between members. To date 34 regulators, including ASIC and the New Zealand Commission, have been accepted as signatories, after rigorous scrutiny of their regulatory frameworks. We are among the first countries to join this powerful network for cross-border exchanges of information and for mutual assistance on enforcement of each country's securities laws. I mentioned the Tranz Rail insider trading action in New Zealand: It was greatly assisted by the use of the IOSCO MOU to obtain evidence in other jurisdictions.

The Commission has also used the IOSCO MOU on a number of other occasions and cooperated with other regulators who had similar information requests. IOSCO has set January 2010 as a deadline for all members to be accepted as signatories to the memorandum, or to be committed to doing so. Signatories must demonstrate they have sufficient regulatory resource and authority in their home jurisdictions to be able to cooperate with their international peers. The MOU on cross-border cooperation has definitely been both a driver and a facilitator of developments worldwide, and in our part of the world.

New Zealand's Position

New Zealand has faced some very specific drivers of its own in recent years. Through much of the 1980s and 1990s, our markets were subject to exceptionally light regulation, with a strong reliance on disclosure by securities issuers and on the ability of other parties to seek civil remedy over breaches of the law. New Zealand was a member of IOSCO but, at times, found itself unable to sign-on to consensus positions. We were, in fact, an international outlier on securities regulation. By the late 1990s, there was growing recognition that our position was disadvantageous in the global capital market. To attract and hold international investment, New Zealand needed to reassure investors about standards of conduct in its market – and that required a substantial re-think of the regulatory framework. New Zealand has moved relatively quickly back towards the international mainstream and through the reforms I mentioned earlier.

In 2003-04, New Zealand was subject to review under the Financial Sector Assessment Programme of the International Monetary Fund (FSAP). The FSAP involves a comprehensive benchmarking of financial and regulatory systems, country-by-country. Receiving a positive assessment is essential for any country wanting to maintain credibility in the international arena. For assessing securities regulation, the FSAP teams of experts use IOSCO's core Principles of Securities Regulation as the benchmark. In the event, New Zealand received a generally positive assessment that reflected developments from 2000 onwards and law reform "work in progress" at the time. Implementation was found to be full, broad or partial in respect of 28 of the IOSCO Principles.

However two Principles were not implemented at all. These deal with collective investment schemes including; unit trusts, superannuation schemes, life insurance policies and contributory mortgages. The FSAP assessment anticipated much of the reform underway in the current Securities Legislation Bill and gave further impetus to the regulation of financial intermediaries. Overall, it confirmed the importance of New Zealand's development as a well-regulated securities market albeit with some reform work still to be done.

Single Economic Market

The other fundamental driver for developments in New Zealand is economic integration with Australia. I mentioned the trans-Tasman relationship and business law coordination before: It is important to see these in their full context given the great store which New Zealand places by its relationship with Australia. We favour the "Single Economic Market" concept and progress on a wide range of topics. Our Governments revised and updated the trans-Tasman MOU on Coordination of Business Law last February and this will give impetus to developments in the securities market area. From the New Zealand perspective, coordination with Australia is a key step to meeting international standards generally and ensuring we are competitive in the wider, global economy.

Concluding Remarks

In concluding, I emphasize the importance to New Zealand of meeting international standards in securities regulation and of cross-border cooperation on matters of enforcement. I emphasize also the value New Zealand places on the trans-Tasman relationship, both in terms of the evolving Single Economic Market and of New Zealand's aspirations to increasingly become part of the global economy.

In summary, the underlying drivers for the key developments in New Zealand's securities market regulation are the reforms of securities law , the expansion of the role of the Securities Commission, the transition to IFRS, and greater coordination across the Tasman.

At the New Zealand Securities Commission we look forward to making further progress with our Australian colleagues.

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