

SESSION V: THE ROLE OF LOCAL INSTITUTIONS: DISCLOSURE CHANNELS

ROLE OF EXCHANGES IN THE SETTING CORPORATE GOVERNANCE STANDARDS

Presentation on by

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¹ One of the major problems in the existing Russian conditions is the problem of the corporate governance quality. From its successful solution there depend not only the country's investment climate on the whole and the stock market in particular, but the investments' structure as well. It is no secret that *in particular the low quality of the corporate governance of the Russian companies keeps back the flow of the foreign investments into the country and is at the bottom of the high speculative component of the investments at the Russian stock market.* The background of the problem of the corporate governance quality lies in the continued redistribution of property in the country, absence of the corporate ethics. Owing to difficulties with receipt of borrowings at the stock market, the companies' administration does not have incentives for disclosing information on their activities.

The corporate governance, if being examined in accordance with the corporate governance principles of the Organization for economic cooperation and development, includes *three main spheres*:

- *The shareholders' rights;*
- *The equal treatment of the shareholders;*
- *The information disclosure and transparency.*

In my speech I would like to dwell on the third issue. Establishment of the information disclosure standards, control over their implementation, creation of the mechanisms preventing trade with usage of the insiders' information are the most important tasks of the general problem of increasing the quality of the corporate governance of the Russian companies-issuers. We believe that the Russian stock exchanges may and have to deal with just these tasks.

Why are the stock exchanges interested in solution of just these tasks first of all?

- *Firstly*, one of the main purposes of the exchange's activities, as the organizer of auctions at the securities market, is to present the high-quality exchange goods to the buyers. The high quality of the traded assets, in our opinion, can be possible only at the corresponding level of the companies-issuers' transparency and at the absence of the insiders' trade with the company's assets.
- *Secondly*, the exchanges have an opportunity to influence on the companies-issuers. In order to do this, the exchanges have embedded mechanisms, which are peculiar only to them, for the establishment of and the control over the information disclosure standards and prevention of the insiders' trade.

What are the projects being implemented at MICEX at the moment?

1. MICEX jointly with TESIS have prepared recommendations for the companies-issuers on establishing *internal "Rules of the internal information use"*, as well have drafted the finished sample of such Rules. This document, firstly, establishes control over dissemination of the internal information in

¹ The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries. This paper is subject to further revision.

the company itself, and, secondly, determines the procedure for and terms of the disclosure of such information by the company-issuer.

Such rules appear to be an obligatory document for the companies from the most Western countries. However, the legal status of the corporate governance codes is not identical in different countries. In certain countries it represents the part of the general set of the obligatory conditions, which should be observed by the companies in order to allow their securities to pass listing at the exchange. At that the essence of the requirements for the securities issuer lies not in the obligatory observance of the code under the threat of exclusion from the listing, but in the obligation to explain publicly the reasons of non-observance of the rules recommended by the code. For example, the companies, shares of which have passed the listing at London and Toronto stock exchanges, are not obliged to follow the Cadbury Code or Dei Code (Canadian version of the model corporate governance code), however, they are obliged to indicate, whether they follow the recommendations of these documents, and to explain the reasons of digression from the recommended standards in the corporate governance system. Such requirement substantially strengthens the obligation level of the codes' recommendations. Sometimes the code or code of rules of the corporate governance may represent a part of the requirements connected with the obligatory information disclosure (Malaysia, Hong Kong, Republic of South Africa).

In other countries the code serves as a document, which is of recommendation nature only and is not connected with any obligatory requirements. As such, for example, there are recommendations on the "model corporate governance" issued by the associations of directors, corporate managers and certain major companies and having particularly voluntary nature. However, even such documents can have a considerable effect. Thus, American institutional investors actively encourage all American companies to observe the corporate governance principles, stipulated in the document adopted by "General Motors". The similar complexes are also completely voluntary in Brazil, Mexico, India and Thailand. The practice proves that availability of such Corporate governance Code or Rules at the companies-issuers allows to considerably decrease volumes of the insiders' trade with the securities as well as to significantly increase the issuers' transparency and to improve the quality of the disclosed information.

2. *Rating company "Standard&Poors", MICEX and MRO FCSM [Moscow Regional Department of the Federal Commission for the Securities Market] implement joint project on creation of the corporate governance quality rating of the Russian companies-issuers.* As of now there have been developed methods of evaluation of the corporate governance quality and performed expert examinations of certain Russian issuers. MICEX expects that clear formalized standards of governance of the Russian companies will be established due to implementation of such project. In the near future a criteria of evaluation of the corporate governance quality will be provided in the exchange's normative acts as the requirements for the securities' issuers in the listing process. Moreover, our drawn standards can be used in the process of development of the Corporate Governance Codes of the Russian companies-issuers.

The materials obtained in the process of implementation of these projects became the fundamentals, on the basis of which there have been formed already adopted requirements for the information disclosure for the companies-issuers of the new Hi-Tech Sector of MICEX. *Thus, the companies-issuers, shares of that are included into the Hi-Tech Sector, are obliged:*

- *to adopt the "Rules of the internal information use";*
- *to disclose immediately potentially insiders' information in accordance with the procedure established in the Rules;*
- *to publish a calendar of their corporate events for a year ahead;*
- *to organize systematic meetings of the company's management with analysts.*

We believe that adoption of such requirements would make the incipient market transparent, even to the Western measures, and then interesting and safe for the investors.

However, it is fondly to hope that only adoption of such requirements can improve the quality of the corporate governance of the Russian companies, to increase the market transparency. Obviously, *effective instruments of control* over fulfillment of the said requirements by the companies are also necessary.

It is supposed to perform permanent monitoring within the framework of the MICEX's Stock Market Sector in order to carry out control over the companies-issuers.

The main tasks of the monitoring shall be as follows:

1. Control over use of the insiders' information. Such control will be performed on the basis of analysis of the volume and price of the transactions with the Hi-Tech Sector's shares, as well as of the information received through the channels of the information agencies and the issuer itself. The purpose of such work is to find the course and temporal dependence between the published materials and the transactions' parameters in order to identify usage of the insiders' information. For example, a substantial growth of the volume and price of the transactions preceding to appearance of a positive information on any issuer may indicate on the usage of the insiders' information.
2. Control over fulfillment of the contractual obligations on the information disclosure by the issuers. It is supposed to compare information on the substantial facts and events received from the issuer itself with the one received through the information agencies' channels. The purpose of this work is to control the issuers' fulfillment of the Sector's requirements for the information disclosure.

We believe that the investors would be interested in applying the similar information disclosure standards to the issuers, shares of which have already been included into the quoted lists. However, there are certain difficulties connected with the fact that the existing FCSM's minimal requirements for the information disclosure standards, as well as for the listing companies, need to be revised. "Gentleness" of the FCSM's requirements for the information disclosure has resulted in the fact that the degree of the market transparency depends on the information policy selected by the companies-issuers.

In order to carry out independent evaluation of such information policy and to create a mechanism of encouragement of the issuers to greater transparency, MICEX intends to implement joint project "INTRA" – INformation TRAnsparency rating – together with the rating service EA-Ratings.

The essence of this project lies in elaboration of an independent opinion on analytic value, transparency and conformity of the information published by the issuers in the formal reporting documents and submitted to the FCSM of Russia, as well as to MICEX, in the event, when the issuer is included into the exchange's quoted lists.

Such work would result in the issuer's evaluation (rating) under the formal scale of the information transparency degree presented to the potential investors and accompanied by the comprehensive commentary in the rating report form.

The following criteria will be used in the course of evaluation of the information transparency degree:

- *Presence (absence) of the information of substantial nature.*
- *Presence (absence) of the non-obligatory, "unnecessary" but at the same time substantial information (i.e., information, which is not listed as necessary and not rigidly required by regulatory authorities).*
- *Delay period of the release (or submission to MICEX) of the quarter or annual report.*
- *Delay period of the release (or submission to MICEX) of the information on substantial events in the issuers' activities.*

It is necessary to proceed from the formal criteria of evaluation, which are specific for the particular field, while assigning the information transparency rating.

What measures, in our opinion, have to be taken in order to attach a greater transparency to the stock market and to prevent the insiders' trade?

1. It is necessary that all companies-issuers, shares of which are quoted at the exchange, adopt the *Corporate Governance Code and the Rules of the internal information use (Compliance Code)*;
2. All companies-issuers, shares of which are quoted at the exchange, are obliged to publish a calendar of their prospective corporate events for a year ahead (Corporate calendar);
3. Volume and terms of the information disclosed by the companies-issuers have to depend on whether the company's securities circulate at the organized market or not. Obviously, the transparency of the companies, securities of which are circulating at the exchange market, have to be lot greater.
4. The information of the company-issuer, securities of which are circulating at the organized market, has to be disclosed within one hour.
5. It is necessary to carry out activities on changing the FCSM's requirements for the information disclosure volume, since certain substantial facts (events) influencing on the traded assets' price are not reflected in the relevant FCSM Regulations, and other substantial facts (events) stipulated in the relevant FCSM Regulations are not as such in practice.
6. The exchange along with the FCSM has to become the Information Disclosure Center at the securities market. Partial re-direction of the information flows from the FCSM to the Exchange would allow to achieve efficiency of the information disclosure at the securities market, which is of great need of the investors, and would allow to avoid the insiders' trade. The Exchange as the Information Disclosure Center is ready to take upon itself the following functions:
 - *Efficient information disclosure, received from the companies-issuers;*
 - *Control over volume, terms and quality of the disclosed information;*
 - *Permanent monitoring of the insiders' trade and price manipulation.*

Such activities of the Exchange have to be under the FCSM's control.

Realization of the listed measures would allow to gradually achieve a greater transparency of the stock market and to a certain extent to prevent transactions with usage of the insiders' information. In its turn this would positively influence on the development of the corporate governance culture in our country.