Organisation for Economic Co-operation and Development
In co-operation with the World Bank Group

The Third Meeting of the
Latin American Corporate Governance Roundtable

8-10 April, 2002
Bolsa Mexicana de Valores, Mexico City, Mexico

"DISCLOSURE AND TRANSPARENCY NON FINANCIAL DISCLOSURE"

(Session 8)

BY

Emilio M. Ferré

Comisión Nacional de Valores

Argentina

A year ago, at the second roundtable on Corporate Governance of the Organization for Economic Co-operation and Development (OECD) and the World Bank, I spoke about the latest advances in this matter in Latin America. And with a view to pointing out the starting point of these advances, I also dealt with the Asian crisis, the creation of the Financial Stability Forum and the publication of the principles of Corporate Gvernance of the OECD

Today, I will go back to approximately the same period, i.e. the year 1998, so as to deal with Disclosure and Transparency and Non-financial Disclosure, but emphasizing the changes that took place after the terrorist attacks of September 11, 2001, which affected New York, Washington D.C. and the whole world, and the Enron case.

Both disclosure and transparency are closely linked; however, they cover a wide area and I will therefore basically stick to three questions:

1) Which are the areas of Non-financial Disclosure to which policymakers, issuing companies, investors and intermediaries should pay the most atention? Are there important deficiencies in the current legal frameworks and in the practices concerning matters such as Management Discussion and Analysis (MD&A), extraordinary events within the company, mergers, acquisitions, market changes, among others?

2) Under what circumstances, if any, may a company ask to free itself from disclosure obligations and what should trigger the obligation to disclose information?

3) Is there a common standard within the region, and between the region and the main financial markets (USA and Europe) as regards regulations and corporte practices related to non- financial information?

In order to answer these questions I will deal with different basic instruments. Also, I must point out that Disclosure, Non-financial Disclosure and Transparency are closely linked concepts.

I have no intention to answer the questions in the order in which they were posed, since providing an answer to one may well answer part of the others.

International Standards for Non-Financial Disclosure

In 1998 the International Organization of Securities Commissions (OICV/IOSCO) approved a document known as "IDS" **(International Disclosure Standards)** whose drafting and approval, particularly in the USA and Europe, took a lot of time and effort. The full name of the document is "International Non-Financial Disclosure Standards for Initial Foreign Issuers".

This document was adopted principally to simplify and make it more inexpensive for companies of third countries to list in more developed countries. The approval of this document was a significant step towards the adoption of uniform information required by more developed countries. As long as companies in one country adjust the information contained in their prospectuses to that required in the document, they will not need to modify or add further information to their pospectuses if they want to list in some other country.

As I said, non-financial information required by the IDS is such infomation as must be included in the prospectus of a public company which desires to list its securities in some other jurisdiction. It is a very important approach to the information to be disclosed by public companies in general.

You can consult all the information contained in that document in the IOSCO web page: http//www.iosco.org. For that reason, I will not mention it here. However, I will refer to all the changes that have taken place since then. I would also like to point out the importance of that document due to the details required as material non- financial information which must be included in the prospectus.

To do honor to our hosts, I will mention that the Mexican National Banking and Securities Commission adopted these standards before they were adopted by the IOSCO itself. Much of this is owed to my colleage Jorge Familiar Calderón, who drafted them and with whom I had the pleasure to participate in the IOSCO work group for several years. The Argentine Securities Commission adopted those standards a short time later. As the standards were very similar to the information that the Argentine Commission asked

Argentine companies to include in their prospectuses (although the IDS required even more detailed information) they were adopted directly as the information that the prospectus must contain if the company wants to go public in Argentina, be such company Argentine or not. Many countries in the region have adopted those standards, as have almost all the securities regulators of developed countries for foreign listing companies.

I have no intention to get into a detailed description of all the titles contained in the document known as IDS, but I suggest that those interested in the applicable rules consult the web page. Those who prefer a spanish version may consult the web page of the Argentine Securities Commission: http://www.cnv.org.ar, and search "Regulaciones, Texto Ordenado 2001, Capítulo I: Prospecto" which goes by the IDS almost literally. Furthermore, Title XXI, ***"Transparencia en el ámbito de la oferta pública"*** (Transparency*)* contains most internationally accepted principles, which, as we shall see, are constantly evolving. In the Western hemishpere, there is a tendency to promptly adopt those IDS as national standards.

Relevant Information

As regards relevant information contained in Title XXI of the Rules and Regulations of the Argentine Securities Commission, we can mention the "Duties imposed on public companies". Section 2 reads: "Managers and members of the supervisory bodies of public companies must report to the Commission every event or situation which may materially affect:

a) Placement of securities of an issuer or

b) The price or volume of its negotiation in the markets.

The information must be reported to the Commission in writing, in a direct, truthful and sufficient manner, immediately after the occurrence of said event or situation, or after these have become known in case the event or situation have originated in third parties..." Subsection 3 enumerates 30 instances in which there is an obligation to inform the Commission immediately.

Confidential Information

The last paragraph of section 3, Title XXI rules: "Upon request of an interested party, the Commission may temporarily excuse compliance of the obligation to inform the public about certain events and previous facts which are not public and whose disclosure may greatly affect social interest. Such permission must be granted for good cause and for a limited period of time." In this case the Commission, the regulator, must set up which social interest may be affected against basically "the course of negotiation, its price and volume within the markets", as stated previously. As an example we can mention that the USA has the intention of obligating companies to report takeover agreements or mergers once these have taken place, but not while negotiations are underway. The regulator must pay attention to the volume and price fluctuations of the shares of that company during a reasonable period prior to the agreement, so as to detect any insider trading

Report on Corporate Governance practices

The preparation and publication of a company´s annual report on practices and internal structures of corporate governance used by that same company may prove very useful to shareholders or qualified investors.

Significant shareholders – Compensation – Conflicts of interest

IDS make disclosure of significant shareholders important. The rules of the Argentine Commission impose the obligation to report changes in stock ownership which involve more than 5% of the company´s stock. Also, IDS obligate to inform shareholders´ voting or other agreements and the possible conflicts of interest between executive officers or directors of a company and said company.

IDS also obligate companies to disclose compensations of members of the Board of Directors and executive officers. We must say that each jurisdiction may establish whether such information should include the aggregate compensation paid or the amount earned by each director or officer individually.

It is also obligatory to report the name of every party materially related to the company´s parent companies and all the transactions with related parties.

Auditing Services

It would be of great use to all shareholders that services rendered by outside auditors be informed, stating which percentage of the fees correspond to auditing services and which percentage should be allocated to other services, such as consultations, computing advice, and so on.

I would like to mention the words of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System at the Stern Business School of the University of New York during the speech delivered on March 26, 2002. He said: "CEOs, under increasing pressure from the investment community to meet short-term elevated expectations, in too many instances have been drawn to accounting devices whose sole purpose is arguably to obscure potential adverse results. Outside auditors, on several well-publicized occasions, have sanctioned such devices, allegedly for fear of losing valued corporate clients. Thus, it is not surprising that since 1998 earnings restatements have proliferated. This situation is a far cry from earlier decades when, if my recollection serves me correctly, firms competed on the basis of which one had the most conservative set of books." These words release me from further comments; still they ratify the importance of reporting any change in auditors, their

fees for auditing services and for other services rendered to listing companies, among others.

New Trends in Disclosure

The Securities and Exchange Commission issued a press release to announce that it intends to propose changes in corporate disclosure rules as the first in a series of steps designed to improve the financial reporting and disclosure system. These include future changes in accounting rules, in the rules to be applied to the auditing profession, in auditing processes and in corporate governance.

The Commission intends to expand the types of information that companies must report on

Form 8-K. Some of the items that the Commission is evaluating for inclusion in these reports include:

- Changes in rating agency decisions and other rating agency contacts;
- Transactions involving the company's securities, including derivative securities, with executive officers and directors;
- Defaults and other events that could trigger acceleration of direct or contingent obligations;
- Transactions that result in material direct or contingent obligations not included in a prospectus filed with the Commission by the company;
- Offerings of equity securities not included in a prospectus filed with the Commission by the company;
- Waivers of corporate ethics and conduct rules for officers, directors and other key employees;
- Material modifications to rights of security holders;
- Departure of the company's CEO, CFO, COO or president (or persons in equivalent positions);
- Final agreements materially relevant to the company (negotiations of these agreements would be excluded from the obligation to disclose until a final agreement is reached). This would be examples of answer to the second question regarding when a company may refrain from disclosing material ainformation to the market.
- Any loss or gain of a client or contract;
- Any material write-offs, restructurings or impairments;
- Any material change in accounting policy or estimate;
- Movement or de-listing of the company's securities from one quotation system or

exchange to another;

- Any material events, including the beginning and end of lock-out periods, regarding the company's employee benefits, retirement and stock ownership plans.

Given the significance of current disclosure of these events to participants in the secondary markets, the Commission intends to propose that companies file reports of these events no later than the second business day following their occurrence. The Commission is also considering whether some of these events require filing by the opening of business on the day after the occurrence of the event.

The Commission intends to propose amendments to its rules for Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) to require disclosure about critical accounting policies. As described in a Cautionary Advice Release issued by the US SEC on December 12, 2001, critical accounting policies are those that are both most important to the portrayal of a company's financial condition and results, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

The proposals may require listing companies to include in their MD&A full explanations, in a clear and comprehensible format and language, of their critical accounting policies, the judgments and uncertainties affecting the application of those policies, and the likelihood that materially different amounts would be reported under different conditions or using different assumptions. The objective of this disclosure would be consistent with the objective of MD&A to provide information on events or uncertainties known to management that would have a material impact on reported financial information. Such disclosure would assist investors in understanding a company's financial condition, changes in financial condition, and results of operations.

Other important changes to be introduced by the US SEC would be to obligate companies to report any transactions involving the company´s securities entered into with its executive officers or directors immediately. This obligation exists today but there is a 45-

day period after the fiscal year to report them. For such reason, a delay of several months may exist before disclosure takes place.

The US SEC press release dated February 13, 2002, states that public comments will be requested so as to adopt new rules as soon as possible . Further information on disclosure of relevant events may be obtained at http:// www.sec.gov/news/press/2002-22.txt.

International Accounting Standards

Going back to "Disclosure" I must mention the International Accounting Standards and their relation with securities regulators. In South America securities regulators do not usually set the accounting standards. In general that task is carried out by Professional Associations. Experience has shown that differences in the rules of the different countries have caused investors to make wrong decisions, due to lack of accurate information or lack of explanations by the auditors of a certain country with respect to financial statements of such country as compared with international accounting principles.

In June 2000, the OICV/IOSCO adopted thirty international accounting standards of the International Accounting Standards Committee (IASC). This was a major step. It took place after more than six years of discussions held between the United States of America, Canada, Australia, Mexico, Hong Kong, Jaspan and the European countries. The Argentine Securities Commission was present at those discussions as chair of Work Group Number 1 Disclosure & International Accounting of the Committee on Emerging Markets of IOSCO, with no voting rights.

The International Accounting Standards are among the twelve (12) standards that the Financial Stability Forum has identified in order to harmonize them internationally.

Transparency

Both the standards of Corporate Governance of the Organization for Economic Co-operation and Development and the International Accounting Standards are among the 12 standards that the Financial Stability Forum intends to reconcile.

Also, two of those 12 standards deal with transparency. They are the “Code of Good Practices in Transparency within Monetary and Financial Policies” and the “Code of Good Practices in Fiscal Transparency”, both codes of the International Monetary Fund.

As regards securities, transparency has always been a goal. Historically, regulators were to ensure “fair, efficient and transparent markets”. Nowadays, the first objective of securities regulation is “to protect investors”; the second is “to guard the achievement of justice, efficiency and market transparency” and the third “to avoid systemic risk”

But when we speak about “transparency” we are talking about predictability as to how a shareholder´s assets will be assessed. We are referring to legislation, rules and regulations that establish “clear and equitable rules for all the participants” and to the fact that existing rules will not be arbitrarily changed regardless of the rights that may be affected by such change. This is known as “Regulatory Transparency”.

The last panel that took part at the annual IOSCO meeting held in 2001 dealt with this subject. Emily Altman , president of the Securitites Industries Association made a presentation, as did Alan Cameron, former president of the Australian Securities Commission and former president of the IOSCO Executive Committee. It was enlightening to listen to those presentations because, although the objective was the same, the perspectives were different.

Alan Cameron began metioning that to make his presentation more real he had decided to look for precedents in the Internet. He had searched the term “transparency” in the OECD web site and had found 1733 documents. When trying to read seven of them there appeared a note which said: “Access to this document is restricted”. He added: “In order to increase comprehension, acceptance and objections to the regulatory and process standards by those who offer financial services and therefore **in order to make**

regulations more effective, members must keep high standards of transparency and abide by those principles within domestic regulations." Then Cameron said: "Effectiveness is the measure in which objectives are achieved, and efficiency is the measure of the use of resources to reach the achievements. I dare suggest that **transparency tends to improve effectiveness**, getting more relevant and useful achievements. **But it also tends to obstruct efficiency**, making decisions slower."

This is particularly relevant in our countries, since we are not used to observation before a rule is set up. In other words, there is an ex post lobbying, that is, lobbying takes place after a rule or regulation has been passed. But we do not criticize prospective rules before they are approved, as is the case at a legislative level.

ALAN GREENSPAN DIXIT

Instead of a conclusion, I consider it more interesting to finish this talk quoting some of Alan Greenspan´s words, which may be applied to Corporate Governance, issuers and brokers, since I have already referred to auditors.

His first paragraph starts as follows: "Corporate Governance has evolved over the last century to more efficiently promote the allocation of the nation´s savings to its most productive uses."

But, as recent history shows, long-term earnings forecasts of brokerage-based securities analysts, on average, have been persistently persistently optimistic" "....this bias apparently has been especially large when the brokerage firm issuing the forecast also serves as an underwriter for the company´s securities.

After analyzing improvements in practices due to an agreement between NASD and the NYSE, he says that in time these practices will improve because investment firms know that safe analyses with no credibility have no market value.

"...market economy require a structure of of formal rules – a law of contract, bankruptcy statutes, a code of shareholder rights, to name but a few. But rules cannot substitute for character. In virtually all transactions, whether with customers or colleagues, we rely on the word of those with whom we do business".

"There can be only one set of rules and it must apply to all. Crafting the rules to provide the proper mix of regulatory and market-based incentives and penalties has never been easy. And I suspect that even after we get beyond the Enron debacle, crafting and updating such rules will continue to be a challenge."

(Remarks by Alan Greenspan, Chairman, Board of Governors of the Federal System, before the New York University Stern School of Business, New York, New York, March 26, 2002).