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## **Issues and Challenges - the Jamaican Experience Towards a Robust Disclosure Framework**

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Good afternoon ladies and gentlemen. This afternoon, I will be sharing with you some of the issues and challenges pertaining to the current disclosure system for issuers and investors in Jamaica. I will also share with you two proposals that are aimed at addressing some of these issues and challenges.

Over the past five years, we have seen significant growth in the Jamaica Stock Exchange's ("JSE") market capitalisation. Specifically, the JSE's market capitalisation has grown from J\$160.1 billion in December 2000 to J\$839.8 billion in December 2005, a phenomenal growth of 425 percent (or an annual average growth of 85%). The significant growth in the JSE's market capitalisation is not indicative of the number of new offerings during this period since at December 31, 2000, there were 44 companies listed on the exchange compared to 41 at December 31, 2005, a decline of approximately seven percent. During the five-

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year period, four new companies were listed while nine existing companies were delisted. These facts lead to the question: why are there so few new listings in light of the phenomenal levels of capital gains earned by many investors over the past five years? This is certainly a subject worthy of deep academic investigations.

While we await such studies, we can safely surmise that one element in the equation for investors could be inadequacies in the quality of the disclosures made by issuers. The FSC has been placing increasing emphasis on the matter of public disclosure with an aim to reshape public disclosure requirements. In Jamaica, the requirements for public disclosure do not lie solely within the purview of the FSC. This responsibility is shared with the JSE and the Companies Office of Jamaica (“COJ”). The FSC being the regulator for the securities industry has sought to stimulate dialogue on the reform of the framework for public disclosure and over a year ago (November 2004) signaled the importance of this process by hosting a symposium on the subject. While the symposium and the accompanying FSC notes on the disclosure framework raised awareness of the subject and helped to focus attention on the demands of a more robust disclosure framework, a year later we would have to say that any improvement in the quality of disclosure for investors is not easy to discern. At the same time, during the year the FSC accelerated its work in considering how to enhance the existing offering and continuous disclosure requirements.

## **I. THE CURRENT DISCLOSURE REQUIREMENTS AND CHALLENGES TO EFFICIENT CAPITAL FORMATION**

Under the current requirements, public offerings of shares and debt securities must be registered with the COJ under the *Companies Act*. An amendment to section 26 of the Securities Act in 2001 created a requirement for every issuer of

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securities to register those securities with the FSC. As a result the prospectus for public offerings has to be filed with both the FSC and the COJ. Further, if the issuer intends to list the securities on the JSE, a copy of the prospectus must also be filed with the JSE and the issuer must comply with the JSE's Business Rules. The prospectus, therefore, has to be independently processed by the three entities in order to ensure compliance with statutory requirements and mandatory rules. The outcome from the perspective of an issuer is a prospectus filing and review process which may unnecessarily increase the cost of capital formation and which, because of duplication and potential delays, may even compromise the success of the offering.

In the case of commercial paper, issuers are required by the Securities (Disclosure of Interest) Regulations 1999 to register with the FSC. The disclosure requirements are very detailed and are said by some knowledgeable commentators to be quite onerous and fairly expensive. More contentiously, some stakeholders have even expressed the view that it was the introduction of regulations for commercial paper that caused its decline in Jamaica.

When it comes to continuous disclosure, the FSC's current requirements for issuers of publicly traded securities are similar to those of the JSE. This is another area of regulatory redundancy. Specifically, unaudited financial statements for the first three quarters and annual audited financial statements are required to be filed with the FSC and with the JSE. Furthermore, the JSE requires an annual report to be filed with it and to be sent to shareholders.

The current disclosure system also requires an issuer of traded securities to disclose immediately any material change in its business operations or capital by issuing a press release and filing a report with the FSC within 10 days after the

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change occurs, a requirement similar to that contained in the JSE's Rules. Finally, sections 54 to 58 of the *Securities Act* require that any director or any person who acquires an interest of 10 per cent or more of an issuer's voting shares must notify the issuer within 14 days of the occurrence of the event or of any change in his control over the securities of the issuer.

The current continuous disclosure system contains numerous regulatory overlaps and the quality of the disclosed information is generally substandard because oftentimes the numbers presented on the balance sheets and income statements are accompanied by neither forward looking nor comprehensive narratives. Furthermore, the disclosure of important corporate events is not always done, and quarterly filings tend to contain little or no qualitative information about the issuer. The current continuous disclosure system does not facilitate an easy evaluation of companies making them more susceptible to market rumours and misunderstanding during periods of financial stress and, frankly, making them less attractive for investors to invest in.

## **II. TWO PROPOSALS**

Against this background, the FSC decided to conduct a comprehensive review of Jamaica's offering and continuous disclosure requirements. This review has shaped the development of two proposals that are aimed at enhancing the public disclosure system. The first proposal is to strengthen continuous disclosure requirements under the securities regulatory regime and the second is to enhance the prospectus disclosure system through a prospectus simplification process. In the coming months the FSC intends to conduct wide consultations with all interested parties with a view to establishing a comprehensive and effective

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disclosure framework under the Securities Act. I would like to share, in outline, these proposals with you.

### **1. Proposed strengthening of the continuous disclosure requirements**

Under the first proposal, the FSC would establish a new set of Continuous Disclosure Regulations. The proposed regulations would replace and enhance the FSC's existing continuous disclosure requirements contained in Part II of the Disclosure of Interest Regulations. The significant areas of the continuous disclosure enhancements would be as follows.

- i) First, there would be a requirement for filing and making available to all holders of securities an annual and quarterly Management Discussion and Analysis ("MD&As"). The MD&As would provide investors with forward looking information about the issuers as well as with current information about their risk management practices ranging from the management of capital resources to the management of liquidity, credit and interest rate risks. This information is not necessarily included in the quarterly or annual financial statements of issuers. MD&As would therefore provide a greater level of transparency to the issuers' business thus stimulating a greater demand for their securities. Markets generally reward high quality disclosure by ensuring that the price of the issuer's security adequately reflects its intrinsic value.
- ii) The second significant requirement would be for an Annual Disclosure Form containing certain items of prospectus-type disclosures such as capital formation and structural changes in the company. This new requirement under the securities regulatory regime would be consistent with the

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requirements for an annual report under the Companies Act and the JSE's Rules. The Annual Disclosure Form would also be a useful and necessary building block towards the FSC's second objective of introducing a simplified prospectus disclosure regime which would require and facilitate timely disclosure of information such as developments in the business, significant acquisitions, clear descriptions of the business and descriptions of new products, etc.

iii) The third important enhancement would be a requirement for disclosure in the Annual Disclosure Form of audit committee information as well as the amount of compensation paid to the auditor for audit and non-audit services. In addition, there would be an associated provision requiring disclosure of the circumstances surrounding a change of the auditor in circumstances where the change results from a disagreement between the issuer and its former auditor.

## **2. Proposed enhancements to prospectus disclosure requirements**

Under the second proposal the FSC would enhance prospectus disclosure requirements by promulgating Registration and Prospectus Disclosure Regulations and by introducing an Integrated Prospectus Disclosure Form.

The proposed regulations would replace the existing registration and prospectus requirements contained in the FSC's Guidelines for Issuers of Securities as well as, it is hoped eventually, the over-lapping requirements imposed under the *Companies Act*. Until then, the proposed regulations would operate in tandem with the requirements of the *Third Schedule of the Companies Act and the JSE's Business Rules*, and would provide investors in both the primary and secondary

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markets with access to much better information than what they presently receive. The information in the proposed Prospectus and Disclosure Regulations would include disclosures specific to the issuer and the offering. These regulations would be quite prescriptive and would include documents required to be filed. They would also specify the solicitation and marketing activities that would be permitted during the registration and prospectus-approval process among other things.

In addition to the proposed regulations, there would be an Integrated Prospectus Disclosure Form that would provide the actual format of the prospectus. This would streamline the prospectus preparation process by standardising the type of information to be included, and would provide new issuers with a prospectus-quality starting point.

### **III. CONCLUSION**

An effective disclosure framework must provide all material information to investors in a timely manner at minimum cost to issuers. We believe that the market would benefit from having a disclosure framework with minimal regulatory overlaps and redundancies and with a higher standard of required disclosures. However, any serious reform of the prospectus and disclosure regime in Jamaica will require close collaboration among issuers, investors, market intermediaries, the legal and audit professions and the various authorities charged with responsibility for this issue (COJ, FSC and the JSE).

Later on in this quarter the FSC intends to commence this process of collaboration by releasing consultation papers setting out in detail proposals for Continuous Disclosure regulations and Registration and Prospectus Disclosure

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regulations to the stakeholders in the industry and to the public at large. I urge those of you with an interest in these matters to look out for these papers and give your attention to their contents when they become available so that you can provide us with your feedback on the proposed requirements and directly influence the final result.

In concluding, I would like to state that the FSC is committed to ensuring a high standard of disclosure that will help Jamaica's capital markets attain greater maturity, sophistication, and transparency. A robust disclosure framework coupled with a strong regulatory regime can work effectively to protect the integrity of the markets and the interests of investors. I ask therefore that you embrace the motivation and purpose behind the forthcoming changes and make your contribution to the ensuing discussion with a view to enhancing the investment experience in the interests of all market stakeholders.

Thank you.

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