

INDEPENDENT STATE OF PAPUA NEW GUINEA



Consultation Memorandum

Seeking Stakeholder Input to Proposed Repeal and Replacement to the

SECURITIES ACT 1997

Content of this Explanatory Memorandum

This memorandum contains two explanations of the three proposed bills.

A. Brief explanation.

This is a brief and general explanation of the bills, the purpose and the policy reasons behind the proposed bills; and

B. Summary of each Part and Divisions.

The Second Part to this brief is an Appendix to this general brief. The Appendix provide for summary of the Parts and Divisions of the proposed bills.

A. BRIEF EXPLANATIONS

PART I BACKGROUND

1. *Background*

- 1.1. The *Securities Act 1997* (“the Act”) was passed in 1997. It was modeled on the *New Zealand Securities Act 1978*. It established the Securities Commission of Papua New Guinea (SCPNG) to regulate the issuance of securities to the public and its related functions. Since 1997, there have been significant changes in the global financial markets with entry of new products on the market.
- 1.2. Significant regulatory changes also occurred in all most all global financial markets centres after the 2008 global financial markets crises and every regulator has updates its legislations to accommodate those changes. PNG also must keep up to the challenging global market environment to ensure that it is par with the latest global developments in the global financial markets.
- 1.3. The *Securities Act 1997* was not able to deal with prevailing and emerging issues and regulatory challenges in the PNG capital market. Those challenges have tested the current regulatory regime and it has been found to be wanting. There is a need to update the legislation to take in new developments within the securities industry globally, including the challenges which are prescribed under the various international pronouncements on the subject area.
- 1.4. Over the cause of administering the *Securities Act 1997*, the SCPNG has found through its own experiences, large tracks of regulatory territory which were not covered in legislation. These include licensing of market intermediaries, disclosure requirements by market participants and market intermediaries, lack of powers of investigations and prosecutions among others. These weaknesses have been expressly demonstrated in a number of key cases involving the SCPNG, including the infamous Commission of Inquiry to the Investment Corporation Fund of PNG, and the Pacific Balanced Fund.

1.5. Reflecting the developments within the country, there is now emerging opportunities to develop the market and its players. The present make up of the Stock Exchange have remained stagnant and confined to a few players since 1997. And while opportunities abound for new players to be admitted, the constitution of the Port Moresby Stock Exchange Limited has been largely restrictive. There is a need to grow the market, admit new players, and structure a securities market which lends itself to participation by Papua New Guinean investors.

2. *Critical Issues with the Securities Act 1997*

2.1. The *Securities Act 1997* has achieved its purpose - the establishment of the Securities Commission and the Port Moresby Stock Exchange. The Act however, failed in a number of important areas (*See 1.4. above*). These include:

- non-compliance with the IOSCO international securities principles;
- non-compliance with the Financial Action Task Forces (FATF) guidelines and standards on Anti - Money Laundering & Counter Terrorism Financing guidelines & standards and the Financial Stability Board standards;
- weak enforcement provisions;
- the lack of clarity in the roles and powers of the Securities Commission;
- the lack of clarify on the roles and functions of the regulator and market intermediaries;
- no clear rules relating to monitoring and enforcement of the market and players;
- No licensing and compliance regime;
- No oversight of market participants and market intermediaries.

- 2.2. A crucial aspect of administration that is also missing is the concept of good governance. Good governance requires transparency, accountability and strong legal processes and administrative mechanisms to protect the institution and the people that the organization seeks to serve. These and other issues of governance need to be rectified to create an effective and active securities commission. Those challenges have tested the current regulatory regime and it has been found wanting. Hence the need for an urgent reform of the securities industry.

PART II INTRODUCTION

- 1.1. This Consultation Memorandum contains:
- (a) a narrative description of proposed new bills to repeal and replace the *Securities Act 1997*. It is proposed that three new bills will replace that current Act. The proposed bills are in the following:
 - (i) *Securities Commission Bill 2014*;
 - (ii) *Capital Market Bill 2014*; and
 - (iii) *Central Depository Bill 2014*.
 - (b) an accompanying detailed discussion of the specific provisions of the above bills under consideration in this exercise.

PART III PURPOSES OF THIS CONSULTATIONS

- 1.1. This Consultation Memorandum is intended to elicit feedback on proposed policy changes under consideration under the current *Securities Act of 1997*. The *Securities Act 1997* has remained unchanged since its passage in 1997. It is modeled closely upon the New Zealand *Securities Act 1978*. New Zealand,

however, has made significant changes to its legal and regulatory framework with the passage of several bills including the *Financial Advisors Act 2008*, *Financial Markets Authority Act* in 2011 and the *Capital Market Conduct Act* in 2013.

- 1.2. The proposed changes are intended to repeal the *Securities Act 1997* with three new bills to bring it in accord with ever-changing trends in corporate governance, regulatory improvements, the International Organisations of Securities Commission (IOSCO) standards, the IOSCO Multi-lateral Memorandum of Understanding (IOSCO MMoU) requirements and the Financial Action Task Force (FAFT) Standards on Anti-Money Laundering & Counter Terrorism Financing (AML & CTF) and the Financial Stability Boards (FSB) Standards.

- 1.3. The proposed changes are to address two key issues currently being faced in the PNG capital market. Firstly, the Securities Commission bill will address the current organisational, functional and operational deficiencies within the establishment of the Securities Commission of Papua New Guinea. It will bring more clearly the objectives of the Commission, the functions and powers of the Commission, funding and the source of funding as well as addressing the current capacity issues. Secondly, the capital market bill and the central depository bill will reform the way the capital market operates in PNG. The bills will introduce a wider and clearer meaning of securities by introducing securities (equity/debt) and derivatives contracts. The bills will open up the now very closed market to new players including the introduction of more stock brokers, investment advisors, trustees, fund managers and other market intermediaries. These market players will to be licensed by the Commission. The Commission

will perform due diligent and fit and proper persons check on directors, and chief executive officers of market intermediaries as well as listed companies. They will also be subject to periodic disclosure requirement.

- 1.4. This Consultation Memorandum is a joint effort between the Securities Commission of Papua New Guinea (SCPNG), Investment Promotion Authority (IPA) and the Ministry of Trade, Commerce & Industry. This Consultation Memorandum will be widely distributed to the public, key private sector stakeholders, government departments and agencies. There will also be a public event in which stakeholders may ask questions and voice their comments on the proposed changes.
- 1.5. The remainder of this Consultation Memorandum provides a narrative overview of the three new bills and the changes which the proposed bills intend to introduce. Then, an appendix to this Consultation Memorandum sets forth a detailed description of the individual statutory sections that are proposed in the three bills.

PART IV NARRATIVE OF GOALS CONTAINED IN THIS PROPOSAL BILLS

The Bills currently under consideration in this Proposed Bills are in the following:

A. SECURITIES COMMISSION BILL 2014

- 1.1. The Securities Commission Bill 2014 is intended to improve the institutional and regulatory capacity of the Securities Commission in the following manner;

- a) Establish the Securities Commission as independent Regulatory Office just like any other securities regulators anywhere in the world.
- b) Provide clear objectives, powers and functions of the Securities Commission;
- c) Provide the clear regulatory, investigations and enforcement framework of the Securities Commission;
- d) Provide clear organisational structure, funding sources and staff capacity of the Commission.

B. CAPITAL MARKET BILL 2014

1.1. The Capital Market Bill 2014 would reform and improve the PNG Capital market in the following manner;

- a) *Establishment of the Securities or capital market in Papua New Guinea their licensing and regulation.*

The markets including;

- (i) Stock market;
- (ii) Derivatives markets;
- (iii) Over - the - Counter (OTC) markets (Registered facilities);
- (iv) Clearing House; and
- (v) Central Depository.

These new inclusions are significant policy and philosophical shift from the current *status qua*.

- b) *Regulating the Capital Market Services*

There are new provisions which are not found under current legislation. These include proper regulation of the market, protection of investors, providing a transparent market and reduction of systemic risks among others. These are some of the key factors the Commission lacks as highlighted by several reports compiled by the Asian Development Bank and the Mutual Evaluation Reports (MER) of the World Bank in 2010. These provisions allow the Commission to issue licenses to market players or intermediaries, including stock brokers/dealers, trustees, fund managers, corporate financing advisors, investment advisors, financial planning advisors, financial journalist and central depository agents. It allows for the Commission to monitor and regulate their activities. The proposed bills will also imposes disclosure requirement by the license holders of their activities on six monthly basis and annually. This will allow transparency and held license holders to be accountable and reduces potential risks and provide a conducive market environment.

It allows for greater and clearer obligations on the market players to protect clients' assets. Clear policy guidelines are provided to ensure that clients' assets are kept separately from their own assets.

c) Approval of Proposals

These are new provisions not found under current law, however, is practised elsewhere in many other jurisdictions. This provides for every person who undertakes a proposal, scheme, transaction, an arrangement or activity, or issue of securities or subscription or purchase of securities or issue and invitation to subscribe for or purchase of securities, in relation to-

- (i) the listing and quotation of securities of a corporation on a stock market;
- (ii) the listing or quotation of securities other than securities in paragraph (i), including units of a unit trust on a stock market;
- (iii) an acquisition or disposal of asset which results in a significant change in the business direction or policy of a listed corporation, listed unit trust scheme or any other listed entity whether or not in relation to any proposal, scheme, transaction, arrangement or activity,

would seek the approval of the Commission. These provides for the Commission to ensure that there is a greater transparency and clarity on issuance of any products including new ones to the market.

d) *Takeovers, Mergers and Compulsory Acquisition*

Current law only provides for takeovers and current provisions are not very clear on many aspects of the takeover process. The proposed changes will also include mergers and provides clearer provisions on compulsory acquisition, which is not clear under current law. This provide for a clearer provisions on takeovers, mergers and acquisition of companies in Papua New Guinea. It also provides for the drafting and approval of a takeovers and mergers code to be approved by the Minister.

e) *Issuance of Securities to the Public*

These provisions provide for clearer provisions on the offer, invitation, or subscription of securities to the public. It provides a detail process on the prospectus and the information that are required to be provided in a prospectus.

f) Debentures

This is a new scheme introduced under the new bills. The current law does not provide for the issuance of debentures in Papua New Guinea. This provision provides for the clear process and requirements for the issuance of debentures, the appointment of trustees, managers and the guarantors of the scheme.

g) Unit Trusts and Managed Investment Schemes

These provisions expand on the current provisions on Unit Trusts. Its provides for clearer provisions on the approval of the Unit Trusts or Managed Investment Funds, their Trustees, Fund Managers, their powers and functions. It also provides for details powers of the unit holders and well as the powers of the Commission over the fund, the trustee and fund manager.

h) Market Misconduct and other prohibited conduct

These provisions expand on the current provisions on market misconducts including market manipulation, false trading, market rigging and insider trading involving securities. A number of new provisions on prohibited conduct related to derivatives have been included. These includes false trading, bucketing, false trading, price manipulation and cornering, employment of devices to defraud,

false and misleading information and abuse of official information.

i) Management of Systemic Risk in the Capital Market

These provisions provides for the Commission to take necessary regulatory actions to preserve the integrity of the market, should a serious risk is posed on the market, whether from internal or external forces.

j) Compensation and Fidelity Funds

These provisions provides for the establishment of funds for the stock market and derivative markets to compensate an investor should he lost his investments as a results of the misconduct of the market intermediary who was engaged to provide stock market and derivative market services by the client. The Compensation fund deals with the stock market risks and fidelity fund caters for the any loss or risk in the derivatives market.

k) Disclosure of Relevant Interest

These provisions are to ensure that listed corporations, their directors and the chief executives conduct to the highest standards. It provides for the directors, CEOs and senior management of listed corporations to be transparent in their dealings with the corporations, its shareholders, its assets and their general conducts. They must disclose their interest to the Commission and the shareholders.

l) Disclosure of substantial Securities Holding

These provisions provides for listed companies and persons who have increased or acquired or disposed of his interest for more that 1% interest of the total security on issue of the corporation to disclose to the corporation and the Commission of the changes.

m) Self-Regulatory Organisations

These provisions provide for the Commission to approve certain licensed institutions such as the Stock Exchange or Derivatives Exchanges as self regulatory organizations. This basically is to allow the organizations to regulate and govern their own operations, whilst at the same time regulating their members or affiliates or agents. The Commission has the powers to revoke such approval if it failed to perform its duties and functions as the terms and conditions of its license.

n) Disclosure of information

These provisions provides for all licensed institutions to disclose to the Commission, the compliance of its regulatory functions under any given standards, guidelines, orders and directors , the audited financial reports, the conducts of business or dealing in securities and derivatives in the given financial year.

o) Capital Market Development Fund

This is also a major policy shift in that the fund is established to promote the development of capital market and build human capacity of the Securities Commission and the securities markets in Papua New Guinea.

p) Administration and Civil Actions

This provision gives the Commission powers to impose administration actions and fines against defaulting persons. It also empowers the Commission to take civil actions where necessary.

C. CENTRAL DEPOSITORY BILL 2014

1.1. This new law will strengthen and compliment the Securities Commission Bill 2014 and the Capital Markets Bill 2014. The draft Central Depository Bill must provide for the following matters:

- Deposit of share certificates for safekeeping; and
- Facilitated the issuances and listings of foreign securities including CDIs on the Port Moresby Stock Exchange; and
- Harmonized cross-border transactions; and
- Increases transparency and safety of stocks traded; and
- Clearing of stocks; and
- Conversion of stocks into tradable shares; and
- A clear link between the regulator, the market and players.