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NZX Listing Rules review

The Institute of Directors (IoD) appreciates the opportunity to comment on the [NZX Listing Rule Review – Discussion Paper](#) (the review) dated 27 September 2017.

The NZX [Listing Rules](#) set out mandatory requirements for issuers listed on the NZX Main Board/Debt Board (and those wishing to list). This is the first major review of the Listing Rules since 2003 and will also impact NZX's other markets, the NXT and NZAX.

Our feedback focuses mainly on the proposed market structure, and governance and board/director matters in relation to equity issuers.

About the Institute of Directors

The IoD is a non-partisan voluntary membership organisation committed to driving excellence in governance. We represent a diverse membership of over 8,500 members drawn from listed issuers, large private organisations, small and medium enterprises, public sector organisations, not-for-profits and charities.

The IoD's *Code of Practice for Directors* provides guidance to directors to assist them in carrying out their duties and responsibilities with high professional standards. All IoD members must sign up to the Code.

Our Chartered Membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good corporate governance.

General comment

The review includes coverage of the market structure, issuers, and products (eg equity, debt, and funds). A key area of reform identified in the review is in relation to small to medium sized (SME) issuers. Feedback to NZX from market participants indicates that the NXT is not meeting the needs of SME issuers (or investors in these entities).

It is important that the Listing Rules are effective, modern and appropriate for New Zealand now and in the future. We support the main objectives of the review which include to:

- reduce complexity with the current three equity market structure and build scale in the Main Board
- enhance investor protections to increase confidence and participation in our markets and reduce the cost of capital for issuers
- accommodate the listing of a broader range of financial products and issuers with fit for purpose rules for smaller issuers, funds and debt issuers

- improve access for foreign listings to expand the range of investable products for New Zealand investors
- remove unnecessary compliance costs, introduce tools to reduce the cost of compliance and ensure the rules are easy to navigate and use.

In updating the rules, we generally support a principles based approach and greater alignment with ASX where this is possible and appropriate. We also support the tailoring of the rules, rather than having a one-size-fits all approach to regulation.

It is not clear to us from the review what analysis and learnings NZX has considered to improve the efficacy of its markets and increase listings. For example in respect of recent:

- IPOs and the issuers’ experiences in coming to the market
- companies choosing to list on ASX instead of NZX
- de-listings of issuers migrating to ASX (eg Xero)
- takeovers.

A considerable amount of trading, by value, on NZX is done off-market and this impacts the market and participants. We encourage NZX to review this area.

In considering NZX’s review we have sought feedback from members. We understand there will be another round of public consultation early next year. We welcome the opportunity for continued involvement as NZX progresses the review.

We make specific comments on 5 key areas:

1. Proposed market structure
2. Eligibility for listing
3. Governance and director matters
4. Disclosure and reporting
5. Shareholder matters

1. Proposed market structure (questions 2-9)

NZX’s proposed new market structure is set out below.



Differential standards

Differential standards are proposed for different types of product classes and issuers (ie fit for purposes rules in relation to equity, debt, and funds). We are supportive of this approach and using the existing rules as a basis for the updated rules, where appropriate.

Single equity market with two tiers

NZX is proposing to combine the three existing equity markets into one, with a single set of rules and differential standards for smaller equity issuers. NZX says it intends to take a similar approach to the London Stock Exchange (LSE) and the UK Listing Rules. The LSE has a mainboard with two tiers of issuers, and it also maintains a separate board, the AIM, for SMEs.

NZX is proposing to have two different types of equity issuers on the one board:

- *Premium issuers*: these would be large issuers and would need to fully comply with the Listing Rules. NZX sees there being more status for premium issuers in having to meet higher standards and so it would provide a point of differentiation for these issuers.
- *Standard issuers*: these would include SMEs and would be subject to more flexible requirements (and less compliance).

We support the concept of having one equity market. However, we encourage NZX to explore further the benefits and risks (including in relation to ASX) of introducing a two-tier system in New Zealand

Our comments below relate to the two tiers of issuers as proposed.

If NZX does proceed with introducing two tiers of issuers, the terms *premium* and *standard* are **not** appropriate descriptors. *Premium* can indicate a level of quality and performance rather than size, and this could be misleading to investors and stakeholders. We suggest more neutral labels, for example connected to the differentiating criteria of the tiers.

Differentiating the two tiers

NZX has suggested options for differentiating the two tiers. Our preferred approach is to divide the tiers based on market capitalisation. We note NXT is currently aimed at SMEs with a market capitalisation of \$10 – \$100 million and most of the companies on the trading facility Unlisted have a capitalisation under \$200 million. The review also states that 35% of listed issuers on the Main Board had a market capitalisation below \$200 million (at September 2017). Taking this and the objectives of the review into account, we believe a market capitalisation of up to \$100 million would be appropriate for standard issuers.

The IoD also supports the concept of issuers that would ordinarily be standard issuers (based on market cap) having an option to *elect* or *opt up* to become premium issuers. NZX will need to highlight and ensure that there are significant benefits of being a premium issuer (only *status* is listed as a key benefit currently).

2. Eligibility for listing (questions 18-21 and 41-42)

Constitutional review

We support NZX's proposal to remove the requirement for constitutions to be reviewed and approved by NZX in order to reduce costs given that issuers already rely upon legal advice in adopting constitutions. NZX will retain the requirement for issuers to obtain a solicitor's opinion to confirm that their constitution meets the requirements under the Listing Rules. NZX may also want to retain a power to review constitutions to ensure compliance.

Spread requirements

NZX is proposing to:

- decrease the spread requirement for premium issuers from 500 to a minimum of 300 and
- increase the spread for standard issuers from 50 to a minimum of 100 (NXT and NZAX markets currently require 50).

We support the increase to 100 for standard issuers but consider that the spread for premium issuers should remain at 500. Low spread requirements could have an adverse impact on market liquidity.

Free float

The current requirement for the Main Board and NXT is for 25% of shares to be in the public's hands. NZX proposes to reduce this to 20%. In our view there should be at least 25%, for example to reduce the risk of undue influence of major shareholders.

Operating record

NZX is seeking feedback whether to introduce additional eligibility requirements for premium issuers wishing to list, eg for companies to have a three year operating record or revenue earning track record, audited accounts or a revised market capitalisation threshold.

We do not see sufficient benefit to introducing additional requirements which could be problematic in some cases, for example if a company floats a division that has not previously been audited or in the case of a high growth company seeking to list without a long enough earnings track record.

Reverse and backdoor listings

NZX is proposing to treat reverse and backdoor listings as new listings in the future to ensure an appropriate listing process is followed. We note that there is already a reasonably robust process in place for reverse and backdoor listings. It is not clear why NZX is seeking to go further and reform requirements in this area and what it is trying to remedy. It is also not clear what deterrent effect this may have on new listings.

3. Governance and director matters (questions 22-34 and 43-49)

Minimum number of directors

The Listing Rules (3.3.1(a)) currently require a minimum of three directors. We support retaining this requirement for both premium and standard issuers. This provides sufficient flexibility for all issuers. However, we would expect most premium issuers to have more directors on their boards in order to effectively drive performance and add value. The optimum board size will depend on many factors including the issuer's size, nature, complexity of its business, and what is necessary to discharge the board's workload.

Rotation of directors - exclusions

The Listing Rules (3.3) allow managing directors and directors appointed by shareholders with express constitutional power to be excluded from director rotation requirements. NZX has asked whether these exclusions should be removed.

We agree that the exclusion for director representatives of shareholders should be removed. However, the managing director exclusion should remain, which would be consistent with the ASX. In addition, removing the exclusion could pose problems for example if a position on the board was in the managing director's employment agreement.

NZ resident directors

The Listing Rules (3.3.1(b)) currently require that a company have two New Zealand resident directors. Amendments to the Companies Act 1993 in 2014 introduced the requirement for New Zealand companies to have at least one director that lives here (or lives in Australia and is a director of an Australian company). NZX has asked whether the Listing Rules should be aligned requiring only one resident director.

The Companies Act requirement provides a minimum standard for all New Zealand registered companies, including companies with just one director. We believe all listed issuers (premium and

standard) should be subject to higher standards given their responsibilities, including to protect the interests of shareholders. We strongly submit that there should be at least two New Zealand resident directors. This is also consistent with the requirements for public companies in Australia.

Director independence requirements

The Listing Rules (3.3.1(c)) currently require two independent directors or three/one-third if there are 8 or more directors. NZX has asked whether it should retain this requirement in the Listing Rules (which are mandatory) or introduce a 'comply or explain' recommendation (potentially for majority independence) within the NZX Corporate Governance Code (NZX Code).

We support maintaining the current mandatory independent threshold requirement in the Listing Rules for premium and standard issuers. The value of independent directors is well recognised and they can bring significant benefits to boards.

We reiterate our views in our first submission in 2016 on the NZX Code that boards should have a majority of non-executive directors. We consider that NZX should give this more prominence and change it to a *recommendation* in the NZX Code (it's currently in the *commentary*).

Principles based test for director independence

NZX has asked whether there should be a more principles based test of independence. We support a principles based approach which is an opportunity for greater alignment with ASX. A holistic and substance-over-form approach should also be adopted. That is, the board should stand back in making its assessment and consider indicators (some of which should be specifically listed in the rules as a general guide) that may taint independence but should not be restricted by them.

Auditor rotation requirements

The Listing Rules (3.6.3(f)) require that the external auditor or lead audit partner is changed at least every five years. In our first submission in 2016 on the NZX Code we supported extending the maximum period for auditor rotation from 5 to 7 years, in line with current FMA and ASX requirements. We still consider a 7 year rotational period is appropriate given the size of the New Zealand auditor pool and the time needed to build specialist knowledge about companies and sectors, especially those operating in a multinational context.

Audit committees

NZX has asked whether the additional audit committee requirements within the Listing Rules (3.6) (eg the requirement to have an audit committee, composition and role) should be moved into the NZX Code. The NZX Code details audit committee matters at recommendation 3.1 and sets out most of the information included in the Listing Rules in the commentary.

In our view the audit committee requirements should remain in the Listing Rules for both premium and standard issuers.

If such requirements were not mandatory, there is a risk that boards could be composed of directors without sufficient skills and experience to effectively carry out the financial oversight and other audit committee functions. This is a critical role of boards. The IoD's *Code of Practice for Directors* (3.12) provides that companies with widely held securities should have an audit committee.

4. Disclosure and reporting (questions 32-34 and 46-49)

New Zealand's securities regulation regime is disclosure based, under which investors should be given timely and accurate information to enable them to make fully informed decisions. NZX proposes to retain the existing substantive requirements for continuous and periodic disclosure. We support retaining this and the proposals to enhance existing tools and guidance in this area.

We agree with NZX's proposal to allow more flexibility in reporting requirements for standard issuers, for example there may be opportunities to streamline the process. However, the quality and content of disclosure should not be compromised in striving for flexibility.

NZX has raised the possibility of introducing quarterly metrics for new standard issuers, eg quarterly operating metrics or quarterly cash flow reporting. On balance, we think this may be too onerous and lead to too much focus on short-term performance.

NZX Corporate Governance Code

We consider both premium and standard issuers should be required to report against the NZX Code.

The 'comply or explain' approach to the NZX Code can support good governance and provides flexibility and proportionality for boards to report in a way that is appropriate and meaningful to the circumstances, size and nature of the entity.

For 'comply or explain' to work effectively there needs to be genuine commitment to good governance and meaningful, open explanations. A constructive culture needs to be fostered where explanations are assessed on their merit rather than assuming non-compliance is inherently negative. Explaining why the issuer has not complied and outlining how practices are consistent with the relevant principle and contribute to good governance and the achievement of business objectives, is good reporting. All listed issuers should be encouraged to engage in meaningful reporting.

5. Shareholder matters (questions 35-40 and 50-52)

Shareholders appoint directors to represent their interests and manage companies. However, shareholders retain some powers and there are measures to hold directors accountable in carrying out their duties and responsibilities. The IoD's *Code of Practice for Directors* recognises the importance of shareholders as owners of companies and of directors fostering constructive relationships with them.

Further issue of securities

The Listing Rules (7.3.5) currently permit the further issue of up to 20% of a class of security by an issuer within a 12 month period without seeking shareholder approval. NZX is seeking feedback on whether to reduce the threshold to 15%. We agree with this proposal, which would also align with ASX in this area.

Major transactions

The Listing Rules (9.1) regulate certain major transactions. Shareholder approval is required if the size of the transaction represents at least 50% of the current average market capitalisation of the company for the 20 business days prior to the transaction being entered into or announced. NZX has asked whether it should reduce the threshold of major transactions to 25% of the size of a transaction. This is a significant change and it is not clear to us why this reduction is necessary and why reform in this area is needed. In addition to increasing the cost of compliance, we can foresee other practical implications this proposal would create for issuers (particularly with issuers on the buy side of sensitive transactions). Accordingly, we don't support a reduction in the threshold.

The focus of the major transaction rule is on the acquisition and disposition of assets. NZX has asked whether the rule should apply to a broader range of transactions. We don't oppose increasing the scope of the major transactions rule, but there would need to be clarity and guidance on the scope.

NZX has also asked for feedback on whether major changes in strategy should be subject to shareholder approval.

The board has a fundamental role in setting, driving and overseeing strategy. It must be continually engaged in strategic matters to ensure the long-term sustainability of organisations. This is especially the case in the complex and challenging operating environment of listed issuers. Boards are best placed to set and monitor strategy and there are already sufficient protections around major transactions for shareholders.

We strongly oppose introducing additional requirements for shareholder approval and also highlight that changes in relation to strategy would be difficult to regulate.

Approving director remuneration

NZX is proposing to retain the basic requirement to obtain shareholder approval for the pool of director remuneration. Shareholder approval is an element of accountability of directors of listed issuers and we agree with maintaining this requirement.

Shareholder meetings (question 75)

NZX has asked whether the requirement to conduct voting by polls should be a mandatory requirement. We consider that this should remain in the NZX Code (together with the other rules around shareholder meetings) and be subject to 'comply or explain' rather than being mandatory.

Conclusion

It is important that the Listing Rules support the success and efficacy of NZX markets, and that they evolve to keep up with corporate governance developments, international trends and best practice.

We support the aims of the review including to build scale and reduce complexity and we generally support the tiered and more tailored approach to equity issuers.

We appreciate the opportunity to comment on behalf of our members and would be happy to discuss this submission with you.

Yours sincerely



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