LISTED COMPANIES ASSOCIATION

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Dear Hamish

NZX Listing Rule Review
Consultation Paper, 11 April 2018

Introduction

By way of preliminary comment, the Listed Companies Association would like to congratulate NZX on the process and the outcome to date of the Exposure Draft for the NZX Listing Rules (**Rules**). The engagement with NZX has been positive and it is clear that NZX have taken account of the market feedback.

The overall impression of the Rules is that they are a substantial improvement in terms of the market structure, policy settings and simplicity. The Rules are easy to navigate and to read. Generally, it was agreed that the Rules are structured a more logical way. It was acknowledged that the reduction of appendices and inclusion of class waivers is a useful change.

As you would expect, there are some areas where further consideration is needed and there are naturally some issues where members of LCA hold varying views. This submission attempts to identify the aspects which cause general concern and to outline areas of debate having regard to the fact that many members or their professional advisers will be making their own submissions.

Objectives of the Review

The LCA considers that the following objectives as described on page 4 of the Consultation Paper have in general been met:

- Reduced market complexity
- Enhanced investor protection
- Simplified rules; easy to navigate
- Reduced compliance cost
- Accommodate more financial products
- Improved access for foreign listings

General Feedback (Section 5 of the Consultation Paper)

LCA agrees with the proposed market structure; updated structure of the Listing Rules; and minimum listing obligations.

Please see the following submissions which address some ongoing listing obligations.

LCA would encourage further discussion with NZX prior to a further draft of the Listing Rules and an opportunity to comment on that further draft prior to finalisation.

There is concern that a 1 January 2019 effective date may be too early if there is a delay in final adoption and approval of the Rules. A six-month transition period should be adequate for companies to prepare for compliance by 1 July, but any delay should see the compliance move to 1 October. We have assumed that during a transition period, issuers can elect from the effective date, to comply with either the now current Listing Rules or the newly effective Rules, but that is not clear. Can NZX please clarify this and if correct, explain how such an election will operate including whether the election can be reversed? Given the wide range of issues covered by the Rules, the most efficient transition would see companies adopt the new Rules as the default position but with liberty for six months to comply with the current Listing Rules. This will allow ongoing compliance of documents and processes already in place as planning for and implementation of the new Rules occurs, but with a clear statement as to which Listing Rule or new Rule the company is relying on.

Specific Feedback (Section 7 - Appendix 2 of the Consultation Paper)

1 Is this an appropriate way to measure Average Market Capitalisation and Average Market Price of an issuer?

The inclusion of a calculation over a 5-day trading period is intended to prevent market manipulation immediately before major transactions are entered into. This is an improvement on the current rule but does not eliminate the scope for a shareholder wanting to ensure that a shareholder resolution is required which they may be able to disproportionately influence. Practically, Issuers will need to closely monitor their share price until the transaction is announced or entered into to ensure shareholder approval to the transaction is not required.

2 Do you agree with the proposed change to the definition of Associated Person to align with the FMC Act?

Although it is useful to have consistent regimes between the Rules and the FMC Act, there are changes between the current definition of "Associated Person" and the new definition (now linked to the FMC Act definition) which require clarification.

For example, section 12 (1) FMC Act includes a "relative" (current LR "spouse, domestic companion, child or parent"); a “substantial degree of influence” (current LR “could be influenced"); specifically includes senior managers (current LR just directors); and now deems A and B to be Associated Persons, if there is another person with which A and B are both associated.

3 Do you agree with the proposed approach to Minimum Holdings?

There is a practical value of a Minimum Holding prior to and upon Quotation but thereafter there appears to be little point. Residual or small holdings inevitably occur as equities are traded and issuers have the means to address them to the extent the servicing costs of such holdings become uneconomic. There is no sensible sanction of an issuer or shareholder when holdings below a minimum occur, nor should there be a sanction.

4 Do you agree with the proposed use of the term Senior Manager?

Yes, we agree with this narrower definition in promoting consistency with the FMC Act and more certainty in addressing the requirements for continuous disclosure. We note and support a wider definition for the specific purpose of diversity reporting.

5 Do you agree with the proposed use of Security?

Yes, this is an appropriate alignment with the FMC Act.

6 Please provide feedback on the definition of a Disqualifying Relationship?

We support the approach of the over-arching test as preferable to deeming provisions which can lead to unrealistic outcomes. An express reference in the definition to the recommended factors for assessing independence at 2.4 in the Code may assist the interpretation of this definition.

Independence of Directors is to be determined having regard to the new "factors" described in the NZX Corporate Governance Code. Reference to these factors might effectively mean that they are used as "deeming provisions". NZX should provide guidance as to how these factors are to be applied by issuers to ensure that the overarching principle is the essential test.

7 Do you agree with the proposed updated eligibility requirement for equity and funds?

The requirements of Rules 1.1.1 and 1.2.1 are appropriate but we note there is no consequence for issuers if at any time following listing the minimum requirements cease to be met. We do not advocate any particular action by NZX but it ought to be clear whether or not there is any consequence. An on-going series of waivers appears futile and likely to impose more burdens on companies likely to be under pressure in such circumstances.

8 Do you agree with the updated approach to Backdoor listings?

We support the approach.

9 **Do you agree with the proposed amendments to the director rotation requirements under Rule 2.7?**

We support the requirement for each director to be re-elected every 3 years or every third AGM, whichever is longer. There is a small practical risk if all directors are to be re-elected at the same AGM and none are re-elected. We suggest some mechanism to avoid a company being left with no directors. For example, the last-voted director continues in office for 90 days notwithstanding the failure to be re-elected.

Rule 2.7.2(b)(ii) Executive Director Rotation: Under the current and proposed rules, there is a requirement for Executive Director to stand for re-election every 5 years. This requirement should be removed.

10 No comment

11 **What is an appropriate time frame to allow issuers to update Governing Documents in response to amended rules?**

Rule 2.20 requires that Governing Documents incorporate specified provisions by reference and comply with the provisions of the Rules. Given the incorporation by reference, NZX should allow for a reasonable period of time to allow for Issuers to amend their constitutions. There were some suggestions from members that the period allowed for transition should be more than 12 months and up to 18 months, provided the next scheduled AGM is more than 90 days after implementation of the new Rules.

12 **Do you agree with the proposal to introduce a concept of constructive knowledge in respect of the continuous disclosure (Rule 3.1.1) requirement?**

No. This proposal met with very strong resistance. The introduction of the new, defined term "Aware" requires the Director or Senior Manager to disclose information they ought reasonably to have come into possession of. This raises considerable uncertainty around an often already difficult concept of Material.

The proposed wording now aligns with ASX but there are different and more severe consequences in New Zealand under the FMC Act for failure to disclose Material Information, if the constructive knowledge is imputed to individuals under that Act also.

The LCA considered that the policy reason for this change in continuous disclosure requirements may be an increased concern around inadequate reporting mechanisms within a company. The group suggested that this rule be re-worded, and instead of importing a "constructive knowledge" requirement, the rule should focus on ensuring that adequate reporting systems are in place and can be demonstrated.

Some other concerns raised were:

- whether this would just cover wilful avoidance, or also include a negligence situation;
- this will disproportionately affect smaller traded stocks;
- there is no defence to this e.g. you can't point to reasonableness to avoid liability;
- this should be more of a Companies Act issue; and
- the relationship between this continuous disclosure requirement and FMCA liability.

13 Do you agree with the proposal to remove the requirement for half year reports and the amendment of "immediately" to "promptly and without delay"?

We support the removal of half year reports. The requirement in Rule 3.26.2 (b) to summarise salient points supporting the release of interim financial accounts is sufficient.

As half year reports will no longer be required, we query why Preliminary Announcements are still required if an Issuer has already completed financial statements. Many issuers incorporate their Preliminary Announcements within their half-year and full year reports A standardised summary of key information can be released in conjunction with the half year and full year financial statements; the release of a "Preliminary" announcement as well as the final financial results is either superfluous or confusing or both.

A Preliminary Announcement is required once information is available (Rule 3.5.1) but in practice the relevant "information" usually takes the form of the financial statements approved by the Board and signed. They are then available for release and must be released to the market.

If there is any reason to continue to require Preliminary Announcements, can at least the Appendix be dispensed with?

A small drafting error was noted, where the reference to rule "3.7.2" should be changed to "3.8".

14 Do you have any feedback on the proposed updates to timing requirements within section 3 of the Rules?

We support the change to refer to "promptly and without delay" as a more practically workable requirement than "immediately".

An issue with this Rule was raised for rule 1.7.2. The rule requires Foreign Exempt Issuer release announcements to NZX "contemporaneously" as to the Issuer's Home Exchange. The requirement in Rule 3.26.2 (d) uses "at the same time". This requirement may prove difficult, especially considering the different time zones involved. The group suggested the wording in both cases be changed to wording such as "promptly and without delay".

It would similarly be helpful to clarify that transmission through MAP constitutes compliance even when NZX is closed overnight or during a weekend or public (NZ) holiday.

15 Do you agree with the new SPP threshold and placement thresholds?

We are generally comfortable with the proposed Rules related to Share Purchase Plans (SPPs) but note that the shareholder approval threshold proposed is a substantial reduction from 30% to 5%. A member noted that a SPP may be considered a "lazy way of doing an AREO" and that this low threshold aims at encouraging issuers to undertake AREOs rather than SPPs

There is difference of opinion among members about the reduction of the placement threshold from 20% to 15% and we recognise NZX has received submissions for much lower limits than 15%. We considered that the reduction in the placement threshold may create difficulty for distressed companies urgently needing additional capital and it was suggested that there should be a waiver or exception available where companies in financial distress are able to issue greater than this threshold (perhaps up to 20%) without shareholder approval. It is acknowledged that distressed companies pose higher risks for new capital but expect that investors will be sufficiently informed of those risks and that the greater risk from delay is insolvency and loss by shareholders of almost all capital.

16 Do you agree with the proposed treatment of Major Transactions?

Disposal or Acquisition of Assets: Rule 5.1.1(a) states that an Issuer cannot acquire, sell, lease, exchange or dispose of assets without an Ordinary Resolution, where the assets would significantly change the "nature or scale" of the Issuer's business. We do not agree with the inclusion of "scale" in this rule. The concept of "scale" alone is highly subjective and a suitable objective test is applied already in reference to acquisitions or disposals above 50% of Average Market Capitalisation. We note NZX has attempted to align with the wording of ASX. However, the ASX rules relating to major transactions operate quite differently (e.g. there is no automatic obligation to seek shareholder approval), therefore the direct insertion into the Rules is not appropriate.

There have been comments in the past about the mandatory requirements for shareholder approval of Major Transactions undermining the ability of NZX listed issuers to compete internationally due to the size of transactions and the requirements of disclosure for the purposes of obtaining shareholder approval. We do not propose any specific solution but would like NZX to consider any possibilities for relaxation of the Rule in such circumstances. We accept that it is not something where a simple waiver would be appropriate.

Rule 5.2.3(f) Transactions with a Related Company: requires the Director or Employee of the Issuer be indemnified where at the time, there is "no likelihood" that the director or Employee concerned will make a claim. The term "no likelihood" is too broad and should be reworded to "no known basis".

“Related Party” Part A definition; under (e)(ii), the wording has changed from where a

director or senior manager does not receive a "material economic interest", to now an "economic interest". This is much broader and will likely unfairly capture more people in this definition.

17 Do you agree with the updated scope for NZX Foreign Exempt Issuers?

Yes, this is a logical change.

It is noted that the NZX does not require directors to provide annual confirmations of compliance with the Listing Rules of their Home Exchange, and that ASX does require this. The group therefore considered whether NZX should have a similar requirement?

We also refer to our comments at 14 above.

18 Do you agree with the changes for settings to Debt.

Yes, these are appropriate and in relation to QPF debt offer documents, a practical removal of a compliance requirement.

19 No comment

20 No Comment

21 No comment

22 Do you agree with these proposed changes? (NZX Review of Documents)

See comment at 18 re QPF documents.

Rule 2.19.1(e) **Solicitor's Opinion** regarding Governing Document: The wording used in this Rule, requires that "issues capable of dispute" are identified. This is unworkable as very many aspects of a Governing Document could be the subject of a dispute. Solicitors should not be required to issue extensive and speculative opinions to meet such a difficult requirement. NZX should change this wording.

23 Do you have any feedback on the proposed criteria for considering independence outlined in recommendation 2.4?

We support these and refer to the comments on independence at 6 above.

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24 Should this recommendation be broadened beyond Annual Meetings to cover Special Meetings as well?

We support the reduction from 28 days to a 20-day notice period for Annual Meetings. Special Meetings are more likely to be held in circumstances where there is some urgency for shareholders to consider a matter and we propose a 10 business day period for notice of Special Meetings.

Additional Feedback

Definitions

Employee

We concerned the new definition includes ”consultants” and "contractors" generally, rather than the current position of "labour only contractors". On the basis of the new definition and in particular the inclusion of “consultant”, lawyers and other professionals advising a listed issuer (as well as their family trusts) could be captured.

Ordinary Resolution

The term "Voting" is used in the definition of Ordinary Resolution. However, the term "Voting" is currently not defined in the Rules. There is a definition of “Vote” and we note its extension by Part B Interpretation 2 (i), but query whether this is an intentional removal from NZX?

Part B – Interpretation

There were some comments from members that perhaps NZX should "enshrine" 1(c), which ensures that the NZX rules are interpreted "in a way that best promotes the principles on which the Rules are based". It was commented that these principles may be lost and re-interpreted over time, therefore is better to have them documented within the Rules.

Rule 2.12.2 Directors' Remuneration

Under the proposed wording for directors' remuneration, it specifies "remuneration for work outside his or her capacity as a director". Members commented that this is often difficult to distinguish between work they do as a director as opposed to carrying out professional services. It was suggested that NZX should further clarify this point.

Rule 6.2.1 Voting Restrictions

There has been a change in voting restrictions. Currently, an "Associated Person" of any disqualified person in the Column 2 of the table could not vote on the relevant resolution. This has been

changed, so that an Associated Person of a Director is not disqualified from voting in a resolution under rule 2.11 or rule 4.2.1. Is that the intended outcome?

Yours sincerely,

John Blair
Chairman

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