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 relatively 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?

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.

Unlike many of the instances under the FMC Act, Issuers (rather than the relevant Associated Persons) will generally be required to identify the persons to whom this definition applies and then apply the relevant provisions of the Listing Rules (e.g. voting disqualifications). Accordingly, we strongly recommend that NZX provide detailed guidance on the application of the definition, and the availability of rulings or waivers in appropriate cases.

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 Annual Meeting, whichever is longer. This flexibility will accommodate the small but unavoidable variances that arise in setting annual meeting dates.

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 12 months. Another suggestion was until the Issuer's next Annual Meeting, provided the next Annual Meeting is not in the next 90 days.

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. 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 determining what is Material Information.

Constructive knowledge introduces significant complexity, both in determining a breach of continuous disclosure (as it necessarily involves a breach triggered by non-disclosure of information that was not known) and also with respect to potential liability in respect

of that breach under the FMC Act (which includes potential liability for individuals involved in the contravention, and it is not clear who would be regarded as having been involved in the contravention triggered by constructive knowledge).

Constructive knowledge also involves more difficult questions of law than the current rules (which generally involve questions of fact) – and a breach of the FMC Act would be triggered by NZX finding a breach of the Listing Rules due to constructive knowledge. The LCA suggests that questions of law such as this are better suited to determination by a court.

The LCA agrees that a robust continuous disclosure regime, and compliance with that, is essential for the proper function of the market. It is essential that Issuers comply with the continuous disclosure regime, and have adequate systems and processes in place that allow them to comply (i.e. so that the persons' whose knowledge triggers continuous disclosure have the information which they ought reasonably to have). If the policy reason for proposing the inclusion of constructive knowledge is a concern whether all Issuers have adequate systems to ensure compliance with continuous disclosure, the LCA suggests that NZX consider introduce specific provisions in the Listing Rules requiring Issuers to have adequate systems and processes in place to ensure such compliance (with guidance on what NZX expects for this). This could achieve the same outcome but without the complexity (particularly for individuals) which would arise from constructive knowledge.

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 (though we acknowledge defences are available under the FMC Act);
- 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 as we believe investors will continue to receive equivalent information without the additional compliance costs of publishing a half year report.

Given the general practice now of issuers to release their half-year or full-year financial statements (either separately or as part of their half or annual report) at the time of their earnings announcement, we query whether the concept of a *preliminary* announcement is still required.

We would encourage NZX to consider whether the information required to be prepared under the proposed new Appendix 2 can be further simplified by requiring the Issuer to (1) prepare half-year and full-year financial statements in accordance with applicable

accounting standards; and (2) provide sufficient commentary on the results for the period so as to enable an investor to:

- compare the information presented with equivalent information for previous periods;
- make an informed assessment of the Issuer's activities and results;
- address any major changes or trends to the Issuer's business subsequent to the end of the financial year or half year.

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 assist distressed companies 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 without shareholder approval.

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" as currently proposed in this rule:

- The reference to “scale”, on its own, does not provide a clear test for determining whether shareholder approval is required (though, by implication, it must be less than 50% of Average Market Capitalisation). Accordingly, we would encourage NZX to provide guidance on the application of this (otherwise, Issuers and their advisers will need to form view on this and, in the absence of a clear test or clear guidance, will likely need to seek rulings or waivers from NZX on this).

- NZX has stated that it has sought to align this test with the equivalent requirements under the ASX Listing Rules. However, these are not equivalent:

    - The ASX requirements are limited to Rule 5.1.1(a) and do not include the quantitative test under Rule 5.1.1(b). Rather, a quantitative test is part of the ASX guidance on the application of the “nature or scale” test.

    - More critically, however, the ASX Listing Rules do not require shareholder approval automatically. Instead, the ASX Listing Rules require notification to ASX and then provide a discretion for ASX to require shareholder approval if ASX considers that appropriate (and ASX has provided detailed guidance on the circumstances where it would consider this appropriate). This approach better lends itself to a test that is not clearly defined, as Issuers can easily err on the side of caution and notify ASX and ASX can confirm a view that shareholder approval is not required. NZX’s proposed approach would require Issuers to either seek shareholder approval or seek a ruling or waiver from NZX (which, even if that results in the same outcome as may be obtained under the ASX Listing Rules, entails substantially greater time and expense for Issuers given the requirements for obtaining a ruling or waiver).

    - NZX’s proposed approach does not provide an obvious exception for “business as usual” transactions which, while significant in scale, may not be sufficiently “transformative” to justify requiring shareholder approval (whereas the approach under the ASX Listing Rules does provide this flexibility). While 50% of Average Market Capitalisation is a longstanding and accepted requirement of the rules that, in effect, provides a quantitative proxy for transactions which are presumptively sufficiently material to merit shareholder approval, the new “scale” limb does not.

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.

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

We support the change from 28 days to a 20 business days' notice period for Annual Meetings being extended to include Special Meetings. A consistency is desirable and Special

Meetings are more likely to be held in circumstances where there is some urgency for shareholders to consider a matter.

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 3.7.1(b)

The requirement to include the top 20 registered holders in annual reports should be limited to looking through NZCSD. Looking behind NZCSD would be unworkable from an administrative perspective. In practice, information on the persons for whom NZCSD holds securities is rela-

tively easy to obtain and consistently prepared. However, even where such information is available, coordinating and verifying information from other sources (e.g. custodial holders) would require significant additional time with no certainty the information provided is accurate or consistent between providers.

Rule 3.24.2

The current rule setting should be retained, with information obtained by Issuers through subpart 5 of Part 5 of the FMC Act only released to the market on request by NZX (rather than in all instances without discretion).

Many Issuers regularly obtain reports on underlying holders, and rely on the powers under subpart 5 of Part 5 of the FMC Act to obtain these reports. These reports are extensive (80-100 pages) and contain detailed information for a large number of holders, whether substantial holders or not (section 290 of the FMC Act). They also do not necessarily consolidate associated holdings. Accordingly, there will be many occasions where this type of information obtained through subpart 5 of part 5 of the FMC Act does not provide useful information for investors and/or is otherwise inappropriate to be released to the market.

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