

Consultation on the Catalist Public Market Issuer Rules

The simplest way for investors and businesses to connect and grow.

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Closing date for feedback on our Issuer Rules: 5pm, 1st May 2020

Catalist is designed to give businesses (“Issuers”) a simple and low-cost way to connect with investors in a well-regulated environment.

The Catalist Public Market Issuer Rules are designed to balance the needs of investors and businesses:

- Investors need easy access to clear, up-to-date information about a listed business whenever they trade, to make an informed investment decision.
- Businesses need simple rules that don’t lead to excessive costs or take the management team’s focus off managing the business.

To ensure we have the balance right, we are seeking public feedback on the Catalist Public Market Issuer Rules. We are keen to hear from representatives of both businesses and investors. This is your opportunity to have a say on how New Zealand’s new growth market for small and medium-sized enterprises will work.

Contents

Introduction	2
Consultation timing	3
Who is the new market for?	4
How is Catalist different from a traditional stock exchange?	4
Regulatory Context	5
Explanation of key rules and suggested questions for feedback	8
Resident directors – Issuer Rule 5.1(a)(i)	8
Independent directors – Issuer Rule 5.1(a)(ii)	8
Anti-dilution provisions for shareholders – Issuer Rule 5.3	9
Additional governance for debt securities – Issuer Rules 5.4	9
Additional governance for managed investment products – Issuer Rules 5.5	10
Corporate governance – Issuer Rules 5.6	11
Disclosure of all material information at each public auction – Issuer Rule 6	11
Format of information disclosure – Issuers Rules 8.3 & 9	12
Enforcement of the Issuer Rules – Issuer Rules 16 & 17	13
Issuer guidance	14
Suggested response format	15

Introduction

The Catalist Public Market is not simply a response to the current Covid-19 situation. We have been working to prepare for its launch for over 18 months. However, the unprecedented pressures currently being faced by small and medium-sized enterprises (SMEs) highlight the critical need for us all to support those SMEs that can enable growth and job creation, through the current difficult times and as we come out the other side.

In a low interest-rate environment, many New Zealanders will also be looking for investments that deliver the potential for higher growth. We believe it is important these investors have access to well-regulated investment opportunities, where they can be confident in the standard of information they receive. For example, complete information about the potential risks and returns.

Catalist was founded because SMEs told us they struggled to raise the money they needed to grow, particularly those that needed between \$2 million to \$20 million in new capital. Investors told us that they would like the opportunity to invest in more SMEs, but it was currently too difficult, costly or only available to professional investors.

Catalist will act as a licensed¹ and regulated stock exchange for SMEs. Our mission is to be the simplest way for investors and businesses to connect and grow. Our listing process is designed to be significantly simpler and lower-cost than a traditional stock-market listing. As well as encouraging investment and secondary market trading in commercial SMEs, the Catalist Public Market aims to make it economical for businesses with a social-impact purpose to list their securities.

In order to give context to the Catalist Public Market draft Issuer Rules we have provided a description of the proposed regulatory framework for the Catalist Public Market. You may also find the following information on our website useful:

- Description of how auctions work:

<https://www.catalist.co.nz/Info/HowAuctionsWork>

- Draft Investor Terms and Conditions:

<https://www.catalist.co.nz/info/documentation>

Consultation timing

Over the last 18 months we've listened to well over a hundred SMEs, social-impact businesses, their investors and advisers about what they need from a new growth market. Our draft Catalist Public Market Issuer Rules reflect their feedback.

We are now seeking your feedback on these Issuer Rules. This consultation document summarises the regulatory context of the Catalist Public Market, describes some of the key rules and sets out a number of questions for you to consider.

You may complete the response form at the back of this document and respond to one or more of those questions, or you may also make comments on any of the other provisions in our draft Issuer Rules by letting us know which rule you are commenting on, the suggested change and your reason for suggesting the change.

Given the current difficulties we all face with the Covid-19 lockdown, we will also be reaching out to interested stakeholders to suggest a short telephone or video conference to allow feedback to be given in a less time-consuming way. Please contact us at consultation@catalist.co.nz if you would like to arrange a telephone or video conference feedback session.

We may publish comments received or a summary of comments. Please indicate in your submission if you have any objection to the release of information contained in your submission.

The closing date for submissions is 5.00pm on Friday 1st May 2020.

Submissions should be sent to: consultation@catalist.co.nz

¹Our licence for the Catalist Public Market is pending while the Government works through some regulatory details. All services are subject to terms and conditions. Further information is available on request.

If you have any queries in relation to this discussion paper, please send them to: consultation@catalist.co.nz

Who is the new market for?

The Catalist Public Market is designed as a 'steppingstone' or 'growth' market to help small and medium-sized businesses grow. We will target listings of businesses that will have an initial market capitalisation, at the time of their listing, of between \$6 million and \$60 million.

If a business's market capitalisation grows to exceed \$100 million, we will help them transition, over a two-year period, to a different market solution. This could involve helping them transition onto a traditional stock market.

We do not have hard limits on the minimum size of businesses we support, or the minimum number of shareholders they must have, however we are targeting businesses that are already established and have outgrown the funding available to them through mechanisms such as angel investment, crowdfunding or friends and family. This means businesses in any industry and with commercial or social-impact purposes can all list on the Catalist Public Market.

How is Catalist different from a traditional stock exchange?

Most traditional stock exchanges facilitate trading of financial products (for example shares or debt securities) on a continuous basis when the market is open. A key difference of Catalist is that financial products are only traded periodically in auctions.

Some investors may perceive this periodic trading as a limitation, because they are not able to transact whenever they choose, but for financial products that do not trade regularly, research² has shown periodic auctions will tend to produce a fairer price for all investors and therefore may actually encourage more trading overall, i.e. better opportunities to buy or sell if an investor wishes to do so.

Our auctions reduce the trading costs for investors by consolidating all order flow over a period of time and executing all successful orders at a single price. This eliminates the bid/offer spreads (the price difference between what you can buy and sell a financial product for) and reduces the opportunity for short-term trading. This means our auctions encourage investors to focus on the medium to long-term growth opportunities rather than encouraging short-term speculation.

At the time of each auction, investors still receive the same high standard of information they would expect in a continuously traded market. Issuers must disclose 'all material information' at each auction, which includes everything a reasonable person would expect

² See papers by Professor Nicholas Economides, Professor of Economics, Stern School of Business, New York University and Professor Robert A. Schwartz, Professor of Finance and Economics and Yamaichi Faculty Fellow, Stern School of Business, New York University.

to have a material effect on the price of the financial product. This requirement is set out in Issuer Rule 6. However, because trading only occurs relatively infrequently, the management burden on the issuer of keeping information up to date is much lower.

For each listed business, the regular auctions will have their own schedule, which might mean an auction every month, quarter, or perhaps just once a year. Businesses listed on the Catalist Public Market can effectively focus on running their business between auctions, without the usual distractions caused by a public listing.

Regulatory Context

The Catalist Public Market is designed to be a licensed financial product market. This means the investor protections in Part 5 of the Financial Markets Conduct Act 2013 (FMC Act) will apply to the market. These protections include, for example, prohibitions against market manipulation and insider trading.

However, unlike traditional stock exchanges, there will be no requirement for continuous disclosure. This is because trading occurs in periodic auctions, so disclosure can also be periodic.

We have been worked with the Financial Markets Authority (FMA), the Ministry of Business, Innovation and Employment (MBIE) and the Takeovers Panel to implement an appropriate regulatory regime for the Catalist Public Market. Our licence for the Catalist Public Market is pending while the Government works through some regulatory details, but some of the key regulatory settings expected are:

More efficient capital raising

Normally, if an unlisted business raises new money from the public, they are required to complete a 'regulated offer' under the FMC Act, which involves significant time and cost.

There are ways that unlisted businesses can raise money from the public without completing a regulated offer, for example they could raise up to \$2 million through a crowdfunding campaign, or they could restrict their offer to only wholesale investors, however in both of these situations, the maxim '*buyer beware*' applies, i.e. investors are responsible for completing their own due diligence and, whilst the businesses are not allowed to give false or misleading information, they are entitled to withhold negative information from investors.

Listed issuers, on the other hand, are required under the rules of the relevant licensed market, to provide investors with all material information. This is why listed issuers have an advantage when it comes to capital raising – The FMC Act allows listed issuers to raise additional capital without completing a 'regulated offer', provided they confirm their information disclosures are up to date. This can dramatically reduce the cost of capital raising for listed issuers.

On the Catalist Public Market, our Issuer Rules require issuers to release all material information at each periodic auction. They do not have to keep information up to date between auctions, because we do not facilitate trading between auctions. Provided issuers comply with the disclosure requirements in the Issuer Rules, we expect issuers on the Catalist Public Market to benefit from legal exemptions that allow them to complete capital raising up to the following limits³, without needing to complete a regulated offer under the FMC Act:

- Up to \$20 million per year, for each issuer, can be raised from regular (retail) investors when the issuer has had their financial products quoted on the Catalist Public Market for at least three months and held at least three public auctions. This will apply to issuers of equity securities, debt securities or managed investment products.
- Prior to being able to raise the \$20 million per year described above, issuers of equity securities or debt securities will be able to raise initial capital of up to \$2 million per year from retail investors.

More appropriate financial reporting

We have tried to keep the financial reporting requirements as simple as possible whilst also ensuring investors have access to high-quality information. See the explanation of what is required by Issuer Rule 7 below.

³ Terms and conditions will apply analogous to the conditions applying to offers made under clause 19 of Schedule 1 of the FMC Act and/or offers made under clause 6 of Schedule 1 of the FMC Act as applicable.

Exemption from Takeovers Code

The Takeovers Panel has approved a policy decision that enables listed issuers on the Catalist Public Market to be able to opt-out of the application of the Takeovers Code⁴.

Catalist's other markets

In addition to the Catalist Public Market, we provide private markets for individual businesses (for example to help manage employee share schemes or private liquidity management). Private markets are managed on behalf of the individual business and are only accessible by their private investors, which means they are not subject to our Issuer Rules. Private markets are outside the scope of this consultation.

⁴ Terms and conditions apply to any exemption, for example, for the Takeovers Code exemption to apply, investors will need to be given information at any relevant auction telling them that rule 6 of the Takeovers Code does not apply in respect of transactions made through the auction.

Explanation of key rules and suggested questions for feedback

We draw your attention to some key issuer rules for the Catalist Public Market below. This is not a summary of all the rules. Listed businesses (**issuers**) will need to comply with all the finalised rules that will be published following our review of any feedback and formal approval of the rules by the FMA.

Resident directors – Issuer Rule 5.1(a)(i)

We propose that issuers must have at least one director resident in New Zealand. The purpose of this rule is to ensure we can easily get in contact with the directors if we need to. However, we acknowledge this may cause additional costs for any non-New Zealand based businesses wanting to list on the Catalist Public Market.

Question 1:

Do you agree with the requirement to have at least one director resident in New Zealand?

Independent directors – Issuer Rule 5.1(a)(ii)

Issuers of equity securities in public auctions will be required to have at least one independent director. This rule is not proposed to apply to public issuers of debt securities or managed investment products.

An ‘independent director’ is defined in Rule 2.1. It means a director of the issuer who is not an employee and who does not have any business or other relationship with the issuer or its directors or senior managers, or other circumstance, that may reasonably be interpreted to materially interfere with the exercise of that director’s independent judgment. Independent directors may hold a small shareholding in the company provided it is not a material amount. Normally someone who owns a substantial shareholding (over 5%) is not considered to be independent.

We believe independent directors can provide a meaningful protection for equity investors in small and medium-sized businesses.

The Issuer Rules also require the issuer to disclose relevant information about the skills, experience, or background of each director and senior manager (see Issuer Rule 5.1(b)), which should help investors to assess the directors and management. The sorts of details that need to be disclosed include details of any previous bankruptcy, conviction for a crime of dishonesty, prohibition from acting as a director, or senior involvement with a business that was subject to appointment of a liquidator, receiver or statutory manager.

Question 2:

Do you agree with the requirement to have at least one independent director for public issuers of equity securities? Do you think this correctly balances the costs with investor protection?

Anti-dilution provisions for shareholders – Issuer Rule 5.3

This rule is proposed to apply to issuers of equity securities, or financial products that can convert into equity. Some shareholders are concerned that their percentage of ownership should not be diluted without them having the opportunity to invest additional funds in proportion to their existing shareholding. This concern is particularly relevant if the company offers new voting shares at a discount.

Rather than having a one-size-fits-all rule that allows a maximum additional amount of shares to be issued each year, the Catalist Public Market Issuer Rules take an approach of requiring transparency. New shares (which includes instruments that are convertible into shares) can only be issued if the issuer uses one of the following mechanisms:

- The offer of shares may be made pro rata to existing shareholders (subject to an exception for foreign shareholders who are subject to securities legislation that makes it unduly onerous to offer the additional securities to them).
- The offer of shares may be made through an auction on the Catalist Public Market. This ensures all existing shareholders have an equal opportunity to fairly bid for the new shares.
- The company can have a standing permission to issue shares (other than through an auction or pro rata offer) if investors have been told about this prior to the first auction or investors have subsequently approved it. This means if a business wants to have a standing permission for placement of, for example, up to 10% of its shares per year, then this is possible as long as investors are made aware of that standing permission and investors can then choose whether to invest based on that information.
- Any other offer of shares may be made with the consent of the affected shareholders.

Question 3:

Do you agree that the approach taken to anti-dilution is simple, understandable, efficient and fair for both businesses and investors?

Additional governance for debt securities – Issuer Rules 5.4

Issuers listed on the Catalist Public Market will be able to rely on the exemptions described on page 6 above to raise capital without triggering a 'regulated offer' under the FMC Act⁵.

In relation to debt securities, we have heard from SMEs and 'social-impact' businesses that these exemptions are important. This is because the costs of a standard 'regulated offer' of debt securities effectively exclude them from being able to raise debt from the public. However, the additional governance provisions generally required under a regulated offer are designed to protect investors. These protections include, for example,

⁵ Parts 3 and 4 of the FMC Act are expected to be disappplied to these offers of debt securities if the issuer meets the conditions of any exemption.

the appointment of a licensed supervisor who can act on investors' behalf if the issuer fails to make any payments that are due.

Although debt issuers will need to comply with our standard market rules, including disclosure of all material information, we believe it may be useful to require some additional minimum governance standards in situations where retail investors can purchase the debt securities.

The proposed minimum standards include appointment of a trustee who can take any enforcement action on behalf of retail investors. We propose the trustee should not need to be licensed under the *Financial Markets Supervisors Act 2011*, as that would create significant costs for SMEs, but we propose the trustee must be independent from the ultimate borrower under the debt securities and must be required to act honestly, with reasonable diligence, and in the best interests of the holders of the relevant debt securities.

We also propose that listed debt issuers must give their retail investors access to an approved dispute resolution scheme for any disputes that arise out of the debt securities, provide information about how the payments mechanisms for the debt securities will work, and provide information about how the issuer will fund the payments due under the debt securities.

We believe this position represents the best balance between the costs for small and medium-sized debt issuers, who will be able to issue up to \$20 million of debt securities to retail investors per year, and the protection of those retail investors. However, we are keen to hear whether you believe these governance requirements are sufficient, or too onerous, and we will then discuss that feedback with the FMA before the Issuer Rules are finalised.

Question 4:

Do you think the additional governance requirements for debt issuers strike the right balance between investor protection and keeping costs appropriate for these small and medium-sized businesses? If not, what would be a more appropriate balance and why?

Additional governance for managed investment products – Issuer Rules 5.5

Managed investment products are a type of collective investment structure. Part 4 of the FMC Act usually requires these structures to comply with significant additional governance requirements, such as standardised reporting requirements, appointment of an independent licensed supervisor, and separate custodianship of scheme property.

The proposed Issuer Rules suggest that, even where an issuer of managed investment products is exempt from complying with the regulated offer provisions in the FMC Act, Catalist can require the issuer to comply with any of these governance requirements in Part 4 of the FMC Act.

These provisions do not apply to collective investment structures that are structured as equity securities.

Question 5:

Should issuers of managed investment products be required to comply with the governance provisions in Part 4 of the FMC Act? If not, what minimum governance requirements do you think are appropriate?

Corporate governance – Issuer Rules 5.6

Catalist encourages issuers on the Catalist Public Market to provide regular reporting on their corporate governance as suggested in the FMA’s Corporate Governance Handbook⁶. Given the size and stage of business of issuers, we do not think it is appropriate to require standardised mandatory corporate governance reporting in addition to the specific business information that issuers are required to disclose.

In any event, the Issuer Rules require issuers to disclose ‘all material information’ (see below) so if governance practices are sufficiently important to affect the value of a business’s financial products, that information will need to be disclosed.

Other important corporate governance information that would need to be disclosed under Rule 6 would include details of any related party transactions to the extent they fall within the definition of ‘material information’, but non-material related-party transactions would not need to be disclosed.

Question 6:

Taking into account the information issuers are required to disclose, do you agree that additional corporate governance reporting should be recommended but not mandatory?

If you think any additional corporate governance information should be mandatory, please describe what information should be mandatory and why.

Disclosure of all material information at each public auction – Issuer Rule 6

“Material information” includes information relating to the issuer, or its financial products, that a reasonable person would expect to have a material effect on the price of the financial products, or would affect an investor’s decision whether to purchase a new issuance of the financial products.

The legal definition of ‘material information’ is set out in Issuer Rule 2.1 and is based on the definitions in the FMC Act. This means it is the same standard of information a listed company on a traditional stock exchange, such as NZX, would normally be required to keep up to date every day. A business listed on the Catalist Public Market only has to update this information before each auction and provide updates if anything changes whilst the auction is open. The requirement to disclose all material information at each auction is subject to exceptions (in Issuer Rule 6.2) that are consistent with the exceptions available on traditional stock exchanges.

⁶ https://fma.govt.nz/assets/Reports/_versions/10539/180228-Corporate-Governance-Handbook-2018.1.pdf

Question 7:

We will be publishing a factsheet to help issuers and investors fully understand the requirement for issuers to disclose 'all material Information'. Are there any particular questions or concerns that you think our factsheet should cover?

Financial reporting and audit – Issuer Rule 7

We have tried to keep the financial reporting requirements as simple as possible whilst also ensuring investors have access to high-quality information.

Unlike companies listed on the NZX's markets, companies listed on the Catalist Public Market will be exempt from being 'FMC Reporting Entities' (as defined in the FMC Act) unless the company is an FMC Reporting Entity for reasons other than their listing. This means companies will need to comply with the Companies Act requirements for financial statements and audits. The Issuer Rules require issuers not to opt-out of these reporting requirements. This means issuers can produce less complex 'Tier 2' financial statements and have those statements audited by any qualified auditor in NZ (rather than an FMC licensed auditor).

Question 8:

Are the requirements for financial disclosures striking the right balance between ensuring investors receive the information they need, and ensuring businesses can easily provide the necessary information without undue costs? If not, why not and what would need to be changed?

Format of information disclosure – Issuers Rules 8.3 & 9

Each auction of financial products will have its own pages in the 'market' section of our website. Here we will upload the information updates provided by the issuer, together with a certificate from the issuer confirming they are in compliance with their disclosure obligations.

Although we have produced guidance for issuers on the content and a suggested format for an issuer's information memorandum, any format is permitted if it meets the requirements of our rules. The rules include a requirement that any information memorandum must be clear, concise and effective at conveying the necessary information.

In addition to any documents containing the issuer's disclosure information, the main auction page for each auction will display some high-level details about the issuer (as provided by the issuer). These details are proposed to include:

- A short introduction to the issuer’s business and the key managers.
- A list of the major shareholders of equity issuers, i.e. legal holders of 5% or more.
- A list of the directors.
- Information about the nature of the quoted financial product (e.g. ordinary shares) and the number issued.
- Information about the prices and volumes traded at any previous auctions.

This summary information is not intended to remove the need for investors to review the detailed information provided by the issuer. It is intended to help highlight some key facts to enable investors to decide whether they want to look further.

Question 9:

Is there any other high-level information we should be showing on the main auction page for each issuer?

Enforcement of the Issuer Rules – Issuer Rules 16 & 17

The Market Rules create binding obligations on our listed issuers and are supported by the protections and remedies in the FMC Act. In order to maintain a fair market Catalyst may also impose sanctions if an issuer breaches the Issuer Rules. Possible sanctions may include a private or public reprimand, an infringement fee not exceeding \$5000 per breach, a requirement to take action to remedy and/or mitigate the impact of the breach, or a requirement to hold an additional auction at the issuer’s cost so that investors can take into account any additional information available.

Any disputed sanction may be subject to an independent review process by a review body appointed under our Issuer Rules Enforcement Policy, which we will publish on our website. The Issuer Rules Enforcement Policy will include provisions that empower the independent review body to order any party to pay the reasonable costs of such review as it thinks fit.

Question 10

We will publish an Issuer Rules Enforcement Policy to describe how we will approach various types of breaches of the Issuer Rules. This will be designed to give issuers and investors greater certainty and to help ensure consistency of treatment. Are there any other matters you think should be covered in the Issuer Rules Enforcement Policy?

Issuer guidance

The Catalist Public Market will be a completely new type of service for New Zealand, although it has similarities to periodic markets that operate in other jurisdictions. We expect issuers and investors will have many questions and need guidance on some of our rules and procedures.

Some of the guidance we will make available on our website will include:

- A factsheet to help issuers and investors fully understand the requirement for issuers to disclose 'all material Information'.
- Guidance on drafting an information memorandum.
- A factsheet explaining the obligations of directors, senior managers and people who have a substantial holding in a listed company to disclose certain changes to their ownership.
- An Issuer Rules Enforcement Policy to give issuers and investors greater certainty over their treatment and to help ensure consistency of treatment.

Question 11

Are there any other matters that you think should be covered in guidance or FAQs on our website?

Suggested response format

Please send your feedback to this consultation by email to consultation@catalist.co.nz by Friday 1st May. It would be helpful if you could provide your feedback in the following format:

Name of person submitting response:	
Business:	
Telephone number: (please provide if you are willing to be contacted by phone if we have questions about your submission)	

Question	Response
Question 1: Do you agree with the requirement to have at least one director resident in New Zealand?	
Question 2: Do you agree with the requirement to have at least one independent director for public issuers of equity securities? Do you think this correctly balances the costs with the protection?	
Question 3: Do you agree that the approach taken to anti-dilution is simple, understandable, efficient and fair for both businesses and investors?	

<p>Question 4: Do you think the additional governance requirements for debt issuers strike the right balance between investor protection and keeping costs appropriate for these small and medium-sized businesses?</p>	
<p>Question 5: Should issuers of managed investment products be required to comply with the governance provisions in Part 4 of the FMC Act? If not, what minimum governance requirements do you think are appropriate?</p>	
<p>Question 6: Taking into account the information issuers are required to disclose, do you agree that additional corporate governance reporting should be recommended but not mandatory? If you think any additional corporate governance information should be mandatory, please describe what information should be mandatory and why.</p>	

<p>Question 7: We will be publishing a factsheet to help issuers and investors fully understand the requirement for issuers to disclose 'all material Information'. Are there any particular questions or concerns that you think our factsheet should cover?</p>	
<p>Question 8: Are the requirements for financial disclosures striking the right balance between ensuring investors receive the information they need, and ensuring businesses can easily provide the necessary information without undue costs? If not, why not and what would need to be changed?</p>	
<p>Question 9: Is there any other high-level information we should be showing on the main auction page for each issuer?</p>	

<p>Question 10: We will publish an Issuer Rules Enforcement Policy to describe how we will approach various types of breaches of the Issuer Rules. This will be designed to give issuers and investors greater certainty and help ensure consistency of treatment. Are there any particular matters you think should be covered in the Issuer Rules Enforcement Policy?</p>	
<p>Question 11: Are there any other matters that you think should be covered in guidance or FAQs on our website?</p>	

If you would like to provide feedback on any other Issuer Rules, it would be helpful if you could provide your feedback in the following format:

Issuer Rule number	Comment or question	Suggestion for change