Capital Markets 2029: Have your say

An invitation to contribute your views and feedback to the Capital Markets 2029 review

May 2019

Background

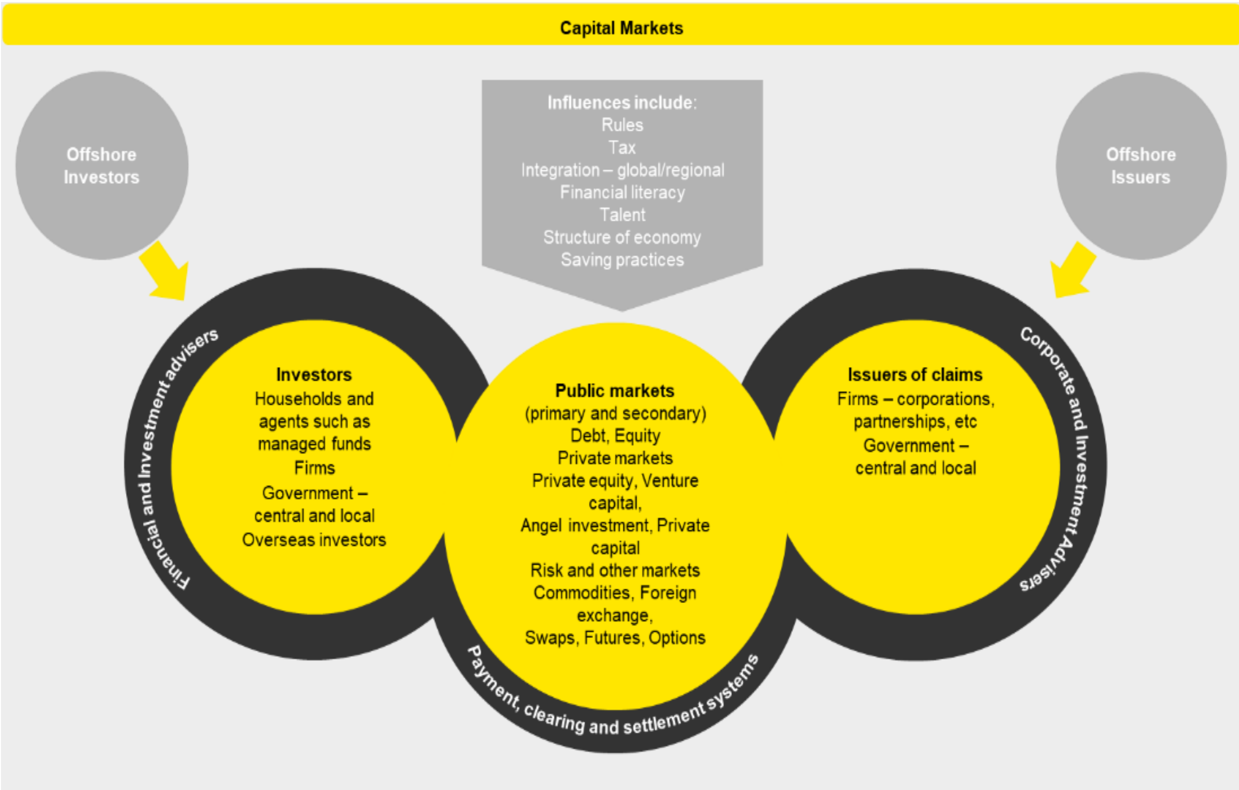
The Financial Markets Authority (FMA) and NZX have initiated an industry-led review of capital markets in New Zealand, namely Capital Markets 2029.

The purpose of Capital Markets 2029 is to deliver a ten-year vision and growth agenda for the sector with more people and companies involved in more vibrant capital markets to build opportunity and wealth for New Zealanders. The review will consider the current framework and broader capital market ecosystem, and outline areas of opportunity for NZ's capital markets to deliver for the New Zealand economy and support delivery of Government policy where alignment exists.

Martin Stearne has been appointed to chair the group and has formed a steering committee, comprising leading representatives of the investment, broking, legal and other associated industries. The Committee is being supported by EY, who have been engaged to be the committee secretariat, provide research, analysis and insight into domestic and international trends and help produce the final report of the committee.

What do we mean by Capital Markets?

The framework provided by the 2009 Capital Markets Taskforce[1] is useful to describe what we mean by capital markets. They effectively sit between investors and businesses that use investors' savings. In this paper the term Capital Markets should be read in this context unless noted otherwise.



[1] Capital Markets Matter, Report of the Capital Market Development Taskforce December 2009

Invitation for feedback

Following consultation with a range of industry participants, the Capital Markets 2029 Steering Committee (Steering Committee) now invites all interested parties to submit their feedback on NZ's Capital Markets to help ensure our final recommendations reflect a breadth of New Zealanders views in promoting the health of NZ's Capital Markets. The Steering Committee has not yet formed its views on the observations shared to date from industry participants.

Your feedback can be made via the webpage: www.ey.com/nz/CapitalMarkets. The closing date for feedback is 5pm, Friday, 7 June 2019.

We encourage feedback in the form of a summary of major points and observations along with any recommendations/solutions identified. Please indicate whether it is okay for the Steering Committee to contact you to discuss the points raised, if required. We do not intend to publish feedback received, however our final report will acknowledge of all those who have materially contributed to the process. We will also respect any respondents' wishes for confidentiality or anonymity.

We thank you in advance for your feedback. Please note the Steering Committee does not intend to make media comment at this time, other than regarding matters of process.

Matters for consideration

What has been working well.

Preliminary observations from industry participants

1. The NZ listed equity market has outperformed other global key equity markets in terms of returns over the recent historical period (NZX50 has generated returns of 13.9% p.a. over the last five years).

2. NZ debt markets have grown in depth and liquidity with corporate debt offerings well subscribed.

3. An efficient listed secondary market has continued to develop, particularly for larger companies. The adoption of the Financial Markets Conduct Act and related Regulations has resulted in "same class offers" allowing existing listed issuers to quickly and efficiently raise capital, which has been seen as a very positive development by respondents.

4. KiwiSaver has been successful in creating a pool of domestic savings and, since inception, has given virtually all participants positive investment returns. There are some recent developments with respect to product innovation and fee reduction.

5. We have witnessed further strengthening of private capital in NZ with a number of PE funds in NZ raising significant funds in recent years.

Feedback points

- What is your perspective of the above observations? Why do you agree or disagree with each of the observations? Are there other successful elements of the Capital Markets which deserve focus?
- What specific initiatives (either public or private) implemented in the past 10 years do you believe have contributed positively to NZ's Capital Markets to date?
- What other views and comments do you have on what has been working well in NZ's Capital Markets over the past 10 years?
- What features of offshore capital markets could be successfully replicated in New Zealand?

NZ as a SME economy and funding gaps

Preliminary observations from industry participants

1. The New Zealand economy is strongly characterised by privately owned, small and medium sized enterprises (SME) covering a wide range of sectors across NZ.

2. Many respondents have observed that whilst there has been significant incremental change in available capital from sources such as private capital (global and local) there remains substantial funding gaps for many companies in NZ to fuel their growth. This has resulted in either no growth or the need to access capital outside of the NZ Capital Markets.

3. In recent years (as commented elsewhere in this paper) there has been little or no appetite from the SME sector to raise capital in the public equity markets which may be explained by other themes in this paper but equally there may be more relevant points that more particularly impact SME owners.

4. Likewise, there has been some initial feedback that listings of growth companies with likely market capitalisations sub ~$100m receive little support from market participants, who are less willing to support/sponsor such smaller scale listings.

Feedback points

- Do you think there is a 'funding gap' and if so what are your views which explain that funding gap? Please be as specific as possible in relation to sector, size of company and/or raise size in your comment on funding gaps.
- Do you think the issue of 'funding gap' is due to lack of funding available, lack of experienced practitioners, lack of efficient/effective mechanisms to marry funding with entities seeking capital or due to other reasons?
- What other new products or market structure initiatives could help resolve this funding gap?
- In other developed markets there has been commentary on enabling more systematic SME funding by setting up an SME fund accessible to a wide range of companies. (For example, the UK government established the Business Growth Fund in 2011 to provide SMEs with long term financial investment). Would you support or oppose this view and why?
- Should government be providing more supportive policies to SME entities and, if so, what should those policies be?

Limited number of new listings

Preliminary observations from industry participants

1. Globally and locally, numbers of IPOs are at low levels. In larger markets, companies are staying private for longer, and average IPO size is increasing.

2. Private equity funds have significant levels of capital available for deployment. At the same time, the extended periods of low interest rates have given companies relatively easy access to capital outside of public equity markets.

3. Some believe New Zealanders highly value privacy and anonymity. Once the entity is listed, wealth becomes immediately visible. Alternative exit pathways perhaps seen as more desirable as they offer greater privacy.

4. Offshore stock exchange platforms have been able to provide support for some small market capitalisation stocks. These companies have seemingly not been well supported by the NZ public equity market.

5. New Zealand media has traditionally emphasised the negative performance of listed companies. High-growth, loss-making, companies have been criticised in the New Zealand market, however equivalent companies in foreign jurisdictions are celebrated for their growth story and future success. There has also been a lack of narrative of the positive aspects of listing: current commentary only speaks to the difficulties and disadvantages.

6. Secondary boards, such as the NCM, the NZAX and NXT have not been successful.

7. Some believe that the listing process is 'too hard' due to rules, regulations and time taken out of from running the business, and that once listed it also looks 'too hard' due to continuous disclosure requirements.

8. Whilst reaction has been mixed, the Mixed Ownership Model recommended in the 2009 Capital Market Taskforce resulted in activity in the public equity markets and a positive experience for investors.

9. There is some consistent feedback on the potential for capital markets to be better utilised to resolve the infrastructure funding challenges in NZ. Further, local councils have been reluctant to partially sell (list) its assets to help their funding programme.

Feedback points

- What factors do you think have driven the lack of IPOs in the New Zealand listed equity markets?
- Should we be concerned by the lack of IPOs in New Zealand listed equity markets or are the alternative capital raising pathways working sufficiently well for issuers?
- How could we fund infrastructural assets via the capital markets?
- What better funding models could be developed by the Capital Markets to support funding of infrastructure in NZ?
- Any other views and comments on listed equity market in New Zealand generally?

Retail investor participation in NZ capital markets

Preliminary observations from industry participants

1. Direct retail investor participation in the market has declined with the move of major brokers to wealth management models.

2. It is hard to access advice on capital market investment unless the investor has a substantial sum to invest. We note regulation of advice will change in the next 1-2 years.

3. The regulatory changes to capital raising by existing issuers has made it easier and more common to include retail investors – either by making offers pro-rata or otherwise accommodating retail investors.

4. Although IPOs are currently al low levels, some feedback indicated retail investors are sometimes unfavourably treated in IPO allocations.

Feedback points

- What specific steps could each of NZX, the FMA, brokers and listed companies take to encourage broader retail investor participation in the Capital Markets?
- How could share offering mechanisms be improved for retail investors?

KiwiSaver

Preliminary observations from industry participants

1. KiwiSaver has materially altered savings and available capital in New Zealand and expected to grow from $50b to over $150b over the next 10 years.

2. KiwiSaver potentially offers NZ's Capital Markets an unprecedented opportunity to fuel growth across the NZ Capital Markets ecosystem over the next 10 years. However, some participants have observed that this goal would be assisted by changes to the way KiwiSaver operates today.

3. Default providers of KiwiSaver products have materially grown their funds under management. Some respondents have questioned whether the obligations of default providers should be changed.

4. KiwiSaver has been described by some as a great savings product but not necessarily a strong investment product. Some have observed the mismatch between the long-term nature of the investors' timeframes versus the short-term nature and liquidity of most of the underlying investments.

5. Disclosure of holdings within KiwiSaver funds, and disclosure of related party transactions could be improved.

Feedback points

- What do you think works well with Kiwisaver as it is currently formed?
- What changes do you think could be made to Kiwisaver to improve its contribution to NZ's Capital Markets, both for issuers and investors?
- What improvements could be made to KiwiSaver providers' disclosure and education obligations?

Regulatory considerations

Preliminary observations from industry participants

1. Same class offers have been well utilised by listed participants allowing significant amounts of capital to be raised efficiently.

2. Disclosure requirements for entities looking to list are not necessarily aligned with the needs of the audience from whom they seek to raise capital. The product disclosure statement has been designed for a retail audience, when generally it is advisors and institutions making investment decisions. Furthermore, prospective financial information requirements are perceived as too onerous and 'opting out' is not a feasible option for most prospective issuers and directors.

3. Disclosure obligations for listed entities are perceived to be burdensome. The market takes a short-term view of a company's prospects. Access to appropriately priced Director & Officer insurance, including specific cover for capital raisings, is becoming a challenge due to the class action environment for listed companies in Australia.

4. There is inefficient use of resources across the NZ Capital Market due to lack of a centralised process for customer onboarding to comply with anti-money laundering (AML) legislation. Currently every financial institution duplicates efforts in relation to customer onboarding.

5. The treatment of listed companies under the Overseas Investment Act ("OIA") is unworkable. Listed companies are unable to reliably and readily determine their overseas ownership as the share register changes daily and shareholders are not required to identify themselves as overseas persons. Moreover, the blunt 25% threshold for becoming an overseas person sees listed issuers with disparate (and in many cases de minimis) overseas shareholdings that do not act together requiring it to comply with the OIA. This is a significant disincentive to listing. In addition, if an 'overseas person' acquires shares in an NZX listed company with an interest in sensitive land and causes the listed company to trip the 25% threshold, the overseas person who acquired the shares requires OIA consent.

   We note The Treasury is currently consulting on proposed changes to OIO regulations and we expect to participate in this process.

6. Financial advisors are hesitant to recommend equity products where third-party research is not readily available, even though this is not a requirement under current legislation. This means that many small market capitalisation stocks receive limited focus by the broking community.

   However, we note new financial advice regulations are being developed and their content and implementation will likely be an area of commentary within the Steering Committee's report.

7. Risk may not be appropriately balanced between investors, issuers, directors and others involved in the capital markets. An imbalance of risk is driving behaviours that are not growth or long-term focused.

Building a better working world

Feedback points

- What are the substantive changes to regulatory settings that you believe would have the greatest positive impact on NZ Capital Markets?
- Is risk appropriately balanced in NZ Capital Markets?
- What regulatory settings in the NZ Capital Markets are working well?
- What regulatory settings in the NZ Capital Markets do you believe are not working well?
- Has regulation of NZ's Capital Markets kept pace with financial and technological innovation?
- Any other views and comments on regulatory settings generally?

NZ's Capital Markets in 10 years' time?

Preliminary observations from industry participants

1. A 10-year time frame is a challenging one, as economies, capital markets, global trade and technologies are highly dynamic and can reasonably be expected to change significantly.

2. In the past decade the NZ Capital Markets have changed markedly. Key changes include partial listing of certain State-Owned Enterprises by the Crown, the systemic change in private equity across local and global private capital markets and the strengthening and development of angel investing in NZ to name but a few.

3. Relatively recent advances in NZ Capital Markets include crowd funding, peer to peer lending and robotic / AI advice. Additionally, a number of online only investment platforms have recently commenced operations in New Zealand.

4. Some participants expect several changes to NZ's Capital Markets that could be enabled by continued advancements in technology platforms across a number of areas e.g. transaction settlement, AML, research.

Feedback points

- What do you think are the key risks and opportunities facing NZ's Capital Markets that this review should be considering?
- Do you think the balance / weighting of NZ's Capital Markets will materially change in the next 10 years and if so what is your view of that balance?
- What specific technological opportunities and risks may continue to emerge that could impact the growth or prosperity of NZ's Capital Markets?
- Do you believe NZX and NZ generally have any unexploited areas of competitive advantage within capital markets?

Feedback for NZX and FMA as regulators and promoters of NZ's Capital Markets and their growth

Preliminary observations from industry participants

1. Although recent improvements have been made, NZX does not sufficiently promote benefits of being a listed entity. Most of their materials speak to compliance and regulation applicable to a listed entity. Industry participants have a lack of exposure to, and understanding of, the benefits of listing.

2. The lack of willingness of regulators to release formal guidance notes are also not helpful in promoting efficient Capital Markets.

3. Some participants want increased efforts from the NZX and FMA to promote growth and vibrancy of Capital Markets.

Feedback points

- What is your experience when engaging with the NZX or FMA on regulatory matters?
- What further things can the NZX and FMA do to promote growth and vibrancy of NZ's Capital Markets? The NZX often receives criticism for lack of listings, is this appropriate?
- What other feedback do you have regarding the NZX and FMA in the context of enhancing NZ's Capital Markets?

Tax settings

Preliminary observations from industry participants

1. There is still disparity between the tax treatment which allows deductibility of costs of raising debt finance versus the cost of equity raising (being non-deductible). Significant non-deductible IPO costs impede listing, whereas the likes of Australia at least allow a 5 year 'black-hole expenditure' amortisation.

2. Tax incentives should be considered to encourage more investment by individuals, for example through KiwiSaver settings or other tax favoured investment regimes like those existing in many offshore jurisdictions.

3. The current tax loss continuity (and forfeiture) rules can dissuade businesses / owners from taking on investment due to the potential for tax losses to be forfeited.

4. Market activity by retail investors is compromised by 'grey' share trading rules. Avoiding being deemed a trader, and thus subject to capital gains tax, reduces liquidity/activity yet PIE funds are not subject to capital gains tax on New Zealand shares.

Feedback points

- Whether tax incentives for individual (or other) investors should be considered to improve capital market investment and engagement?
- Whether changes could be made to NZ's tax loss continuity rules?
- Any other views and comments on the tax environment and settings generally?

Any other areas

The Steering Committee welcomes views and comments on any other matters in relation to improving the NZ's Capital Markets.

Building a better working world

How to submit your feedback

- Please submit your feedback via the website www.ey.com/nz/CapitalMarkets
- Closing date: 5pm, Friday, 7 June 2019.

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