



COVERSHEET

Minister	Hon Dr David Clark	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Regulations to facilitate the operation of a 'stepping-stone' financial product market	Date to be published	By 29 June 2021

List of documents that have been proactively released		
Date	Title	Author
November 2020	Agreement to regulations for a 'stepping-stone' financial product market	Office of the Minister of Commerce and Consumer Affairs
20 November 2020	Proposed Regulations for a 'stepping-stone' Financial Product Market DEV-19-MIN-0313	Cabinet Office
May 2021	Regulations to facilitate the operation of a 'stepping-stone' financial product market	Office of the Minister of Commerce and Consumer Affairs
13 May 2021	Regulations to facilitate the operation of a 'stepping-stone' financial product market LEG-21-MIN-0059	Cabinet Office
May 2020	Impact Summary: Assessment of regulations under the Financial Markets Conduct Act 2013 for 'MyCap Markets'	MBIE

Information redacted

NO

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In Confidence

Office of the Minister of Commerce and Consumer Affairs

Cabinet Legislation Committee

Regulations to facilitate the operation of a 'stepping-stone' financial product market

Proposal

- 1 This paper seeks authorisation to submit to the Executive Council the following regulations and Order in Council, which set alternative disclosure, financial reporting and auditing requirements and approve the use of an electronic transfer system to allow for the operation of a 'stepping-stone' financial product market:
 - 1.1 Financial Markets Conduct (Catalist Public Market) Regulations 2021.
 - 1.2 Financial Markets Conduct (Approval of Catalist Electronic Transfer System) Order 2021.

Executive Summary

- 2 This paper seeks approval for regulations and an Order in Council to provide for the operation of a 'stepping-stone' financial product market by Catalist Markets Limited (Catalist).
- 3 This market aims to provide a lower-cost intermediate step between private funding and traditional public listing for small-to-medium growth companies seeking capital. After reaching a certain market capitalisation threshold, companies would step from this market to listing on traditional stock exchanges such as the New Zealand Exchange (NZX).
- 4 Catalist applied to the previous Minister of Commerce and Consumer Affairs for a licence under the Financial Markets Conduct Act 2013 (the Act). The previous Minister notified Cabinet of his intention to issue the licence, subject to conditions and regulations being made to support the market's operation, in November 2019 [DEV-19-SUB-0313 refers].
- 5 The proposed Catalist Public Market (the market) will be targeted primarily at small-to-medium growth companies. These are companies who would benefit from raising capital (of around \$2 million to \$20 million) to grow but cannot easily afford the initial and ongoing compliance costs of listing on the NZX. Access to capital is especially important to support the economic recovery following the impacts of COVID-19.
- 6 The distinctive characteristic of the proposed market is that products on it will only trade during periodic auctions, which is in contrast to the NZX and most international markets which trade continuously. This is intended to reduce the

costs for issuers, in recognition of the growth nature of the market, because trading will only be available during limited windows, with disclosure requirements limited to those windows rather than applying continuously.

- 7 This paper specifically seeks approval for the following regulations that will support the market to operate:
 - 7.1 Financial Markets Conduct (Catalist Public Market) Regulations 2021 – providing for alternative disclosure provisions and reporting requirements that reflect the periodic trading model and ‘stepping-stone’ nature of the market.
 - 7.2 Financial Markets Conduct (Approval of Catalist Electronic Transfer System) Order 2021 – allowing for financial products to be transferred through an electronic transfer system.
- 8 In parallel to the development of the regulations and Order in Council, the Financial Markets Authority (FMA) is making an exemption for the new market from certain regulated offer requirements under the Act, and the Takeovers Panel is making an exemption for the market from one aspect of the Takeovers Code.
- 9 Once the regulations and Order in Council are in place, I intend to issue a licence to Catalist Market, and the market will be able to begin operating. This will mean that small-to-medium businesses will be able to begin listing on the market to access capital to support their growth.

Background

I intend to issue a licence to Catalist Markets Limited to operate a financial product market

- 10 Catalist applied to the previous Minister of Commerce and Consumer Affairs for a licence under section 315 of the Act to operate a ‘stepping-stone’ financial product market targeted primarily at small-to-medium growth companies. These are companies who would benefit from raising capital (of around \$2 million to \$20 million) to grow, but cannot easily afford initial and ongoing compliance costs of listing on a traditional stock exchange such as the NZX.
- 11 Catalist is a new stock exchange company designed for small and medium-sized businesses. Under the Act, the FMA is required to advise the Minister on the application, including whether the applicant is capable of operating a financial product market in accordance with the general obligations of the act. The FMA advised that Catalist is capable of doing so, and that the licence should be granted.
- 12 The previous Minister noted to Cabinet his intention to issue a licence under the Act for Catalist to operate the Catalist Public Market, subject to certain conditions, including caps on the size of issuers eligible to list on the market

[DEV-19-SUB-0313 refers]. A copy of the updated draft licence conditions is attached at Appendix 1.

- 13 The distinctive characteristic of the proposed market is that products on it will only trade during periodic auctions, which is in contrast to the NZX and most international markets which trade continuously. This is intended to reduce the costs for issuers, in recognition of the growth nature of the market, because trading will only be available during limited windows, with disclosure requirements limited to those windows rather than applying continuously.

Regulatory changes are necessary for the new market to operate

- 14 Regulatory changes are needed to the general obligations in the Act that would otherwise apply to the proposed market. These are required to facilitate the periodic trading and disclosure model, while ensuring that the appropriate protections for consumers are in place. They are also important to ensure that the costs are appropriate for, and do not act as a barrier to, small-to-medium growth companies listing on public markets.
- 15 An Order in Council is also required to approve the proposed electronic transfer system that provides for the transfer of financial products through an electronic system.

The Act facilitates regulatory changes to promote different markets

- 16 One of the specific purposes of the Act is to promote fair, orderly, efficient and transparent financial product markets. At the same time, the Act is intended to encourage a diversity of financial product markets to take account of the differing needs and objectives of issuers and investors.
- 17 To achieve those purposes, the Act requires that financial product markets are licensed, and it also sets out the general obligations and requirements for those who operate financial product markets, and those who issue and trade on them. To allow for a diversity of markets, the Act provides flexibility to change the general obligations that apply for particular types of markets.

Accordingly, Cabinet agreed that regulations be made to facilitate the operation of a 'stepping-stone' financial product market with a periodic trading model

- 18 On 20 November 2019, Cabinet Economic Development Committee agreed that regulations be made to facilitate the operation of a 'stepping stone' market and to approve the proposed electronic transfer system for this market [DEV-19-MIN-0313 refers].
- 19 The regulations give effect to decisions by the Cabinet Economic Development Committee in November 2019 to provide for disclosure and financial reporting requirements specific to the market and for the approval of the electronic transfer system [DEV-19-MIN-0313 refers].

I sought independent advice before deciding to proceed with this licence application

- 20 MBIE and the FMA recommended proceeding with the application. However, I sought extra assurances around some of the potential conflicts of interest arising from the Catalist Chief Executive formerly being a senior FMA employee. In particular, I asked Sir Brian Roche to review the process undertaken by the FMA to determine whether or not these conflicts of interest were appropriately managed.
- 21 Based on Sir Brian's conclusions, I am satisfied that the FMA's process was sufficiently robust for me to have confidence in their advice to grant Catalist a financial product market licence to operate the market.

Regulations for approval

Financial Markets Conduct (Catalist Public Market) Regulations 2021

- 22 The purpose of the regulations is to enable Catalist to operate a market with market rules that facilitate the periodic trading model and reflect its "stepping-stone" nature.
- 23 These regulations are made under section 351 of the Act, and will change some of the obligations and requirements that apply to issuers on the proposed market, specifically disclosure and financial reporting and auditing requirements.

Alternative disclosure requirements

- 24 The default position under the Act for ongoing disclosure of information by issuers offering financial products is that information about all events that are material to the price of quoted financial products must be disclosed continuously. Continuous disclosure was designed to promote a market that is fair, efficient and transparent.
- 25 Cabinet has agreed to an alternative disclosure regime that will allow for periodic disclosure to fit with the proposed periodic trading nature of the market. The regulations provide for this alternative disclosure regime. Under this regime, material information will need to be disclosed, but only by the start of, and during, each trading auction.

Reduced reporting requirements

- 26 The Act designates certain entities as 'FMC reporting entities' which are subject to a higher standard of financial reporting and auditing requirements. This is generally where there is a higher degree of public interest, and more rigorous and definite reporting standards are appropriate.
- 27 The Act allows for regulations to be made to provide that issuers are not 'FMC reporting entities' if the only reason for this is that they are listed on a specified financial product market. Cabinet has agreed to exempt issuers on this market who are caught on this basis. The regulations give effect to this.
- 28 Issuers will only be exempt from being FMC reporting entities under the proposed regulations if they comply with market rules that relate to:

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- 28.1 the preparation of financial statements or group financial statements;
- 28.2 the audit of those statements by a qualified auditor (but not by an FMC licensed auditor);
- 28.3 the registration or lodgement of those statements and a copy of the auditor's report on those statements; and
- 28.4 not opting out of these requirements (unless no retail investors are able to participate in auctions held by the issuer).

Financial Markets Conduct (Approval of Catalist Electronic Transfer System) Order 2021

- 29 The Order in Council relates to the approval of a system that is wholly electronic for the transfer of specified financial products under section 376 of the Act.
- 30 Share ownership must be transferred electronically for Catalist to operate efficiently. If share ownership of a listed financial product is to be transferred electronically, it must be done so using an approved electronic transfer system. Electronic transfer systems must be approved by the Executive Council under the Act.
- 31 Cabinet has agreed that the proposed electronic transfer system should be approved under section 376 of the Act, subject to certain terms including that the market rules provide that independent technical testing on the system is carried out annually.
- 32 The Order in Council provides that the electronic transfer system is approved, and sets out the essential requirements of the system, including:
 - 32.1 connecting to the system;
 - 32.2 electronic submission of an order for specified financial products;
 - 32.3 the procedure for auctions using the system;
 - 32.4 Catalist Markets Limited's roles as registry and transfer agent; and
 - 32.5 essential provisions in the market rules relating to electronic transfer and essential features of the system.

Other items under development for the market to operate as proposed

FMA exemption from "regulated offer" requirements

- 33 The FMA has approved in principle granting an exemption under section 556 of the Act. This will exempt issuers on Catalist Public Market from "regulated offer" requirements, including issuing a "Product Disclosure Statement" (which provides investors with key information), when:

- 33.1 raising \$2 million or less in any 12-month period; and
 - 33.2 issuing financial products of the 'same class' as those which have already been issued, provided that the financial product has been trading for at least three months and during at least three auctions. This is limited to \$20 million or less in any 12-month period.
- 34 The intention is that the exemption will be granted on or about the time that the regulations come into effect, and the licence is issued.

Takeovers Panel exemption from rule 6(1) of the Takeovers Code

- 35 The Takeovers Panel is progressing an exemption from rule 6(1) of the Takeovers Code, which will allow any person to increase their holding or control of voting rights in certain companies listed on the market, above the 20% threshold set by rule 6(1) of the Code, without the need to comply with one of the exceptions to rule 6(1) outlined in rule 7 of the Code.
- 36 This exemption is intended to be in place for when the regulations come into effect and the licence is issued. However, this exemption is not required for the regulations to take effect or the market to operate.

FMA approval of market rules

- 37 The FMA is required to approve the proposed market rules that Catalyst Markets Limited has developed. Catalyst consulted publically on draft rules in April 2020. The FMA will undertake a final review of the rules once the content of the regulations is finalised. The intention is that the rules will be approved on or about the time that the regulations come into effect, and the licence is issued.

Licence application approval

- 38 Once these regulations have been approved, I will issue the licence with an effective date that aligns with the regulations coming into effect.

Timing and 28-day rule

- 39 I am not seeking a waiver of the 28-day rule.
- 40 Should the regulations be approved for submission to Executive Council, the regulations will come into force on the week of 21 June 2021.

Compliance

- 41 The regulations comply with each of the following:
- 41.1 the principles of the Treaty of Waitangi;
 - 41.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993;

- 41.3 the principles and guidelines set out in the Privacy Act 1993;
- 41.4 relevant international standards and obligations; and
- 41.5 the Legislation Guidelines (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

Statutory pre-requisites

- 42 For regulations to be made under section 351 of the Act, relating to providing for the disclosure obligations and financial reporting and auditing requirements that apply to issuers on the market, the Minister must:
 - 42.1 have regard to the matters set out in section 308, including:
 - 42.1.1 the purposes of Part 5 of the Act which seeks to promote fair, orderly, efficient and transparent financial product markets and encourage diversity of markets for issuers and investors;
 - 42.1.2 the nature of the activities conducted and financial products dealt with, as well as the size of the market, its participants and the technology to be used; and
 - 42.1.3 be satisfied that the extent to which the regulations disapply any enactment is not broader than is reasonably necessary to address the matters that give rise to the regulations.
- 43 For regulations to be made under section 376, to approve the electronic transfer system, the Minister must seek advice from the FMA. The FMA must consult the persons it considers will be substantially affected by the Order in Council before making a recommendation to the Minister.
- 44 I have considered all of the necessary pre-requisites under the Act and I am satisfied that they have been met.

Regulations Review Committee

- 45 I do not consider there to be any grounds for the Regulations Review Committee to draw these regulations to the attention of the House of Representatives under Standing Order 327.

Certification by Parliamentary Counsel

- 46 The draft regulations have been certified by PCO as being in order for submission to Cabinet.

Impact Analysis

- 47 A Regulatory Impact Assessment was prepared in accordance with the necessary requirements, and was submitted at the time that Cabinet approval was sought of the policy relating to the regulations [DEV-19-MIN-0313 refers].

Publicity

- 48 Once the regulations have been made, I propose to issue the licence and announce that I have issued a licence to operate a 'stepping-stone' financial product market aimed at small-to-medium growth companies, and that the regulations to allow that market to operate have been made.

Proactive release

- 49 I plan to proactively release this paper on MBIE's website, alongside the paper that was considered at Cabinet Economic Development Committee and the accompanying Regulatory Impact Statement, with any necessary redactions for commercial sensitivity, once the regulations have been made and the licence has been granted.

Consultation

- 50 The FMA, who provided advice to me in assessing the licence application and approving the electronic transfer system, was consulted on this paper and on the draft regulations.
- 51 I have consulted with the Treasury and the Takeovers Panel in regards to the contents of this paper.
- 52 I have also consulted the applicant on the draft regulations to confirm that there are no unintended consequences on the operation of the market.
- 53 The Department of the Prime Minister and Cabinet has been informed of the contents of this paper and the draft regulations.

Recommendations

I recommend that the Cabinet Legislation Committee:

- 1 **note** that the previous Minister of Commerce and Consumer Affairs received an application from Catalist Markets Limited for a licence to operate a financial product market, and previously advised Cabinet of his intention to issue the licence, subject to conditions [DEV-19-MIN-0313 refers].
- 2 **note** that on 20 November 2019 the Cabinet Economic Development Committee agreed that regulations be made to facilitate the operation of a 'stepping-stone' financial product market, specifically to set the alternative disclosure and reporting requirements [DEV-19-MIN-0313 refers].
- 3 **note** that the Financial Markets Conduct (Catalist Public Market) Regulations 2021 and the Financial Markets Conduct (Approval of Catalist Electronic Transfer System) Order 2021 have been drafted and give effect to the decision in paragraph 2 above.
- 4 **authorise** the submission to the Executive Council of the Financial Markets Conduct (Catalist Public Market) Regulations 2021.

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- 5 **note** on 20 November 2019 the Cabinet Economic Development Committee agreed that regulations be made approving the electronic transfer system proposed by Catalist Markets Limited under section 376 of the Act.
- 6 **note** that the Financial Markets Conduct (Approval of Catalist Electronic Transfer System) Order 2021 has been drafted to give effect to the decision in paragraph 5 above.
- 7 **authorise** the submission to the Executive Council of the Financial Markets Conduct (Approval of Catalist Electronic Transfer System) Order 2021 to approve the Catalist Public Market electronic transfer system.
- 8 **note** that once regulations and Order have been made, I will issue the licence and announce that I have issued a licence and that the regulations to allow that market to operate have been made.
- 9 **note** my intention to publish this Cabinet paper and supporting documents on MBIE's website, with any necessary redactions for commercial sensitivity, once the regulations have been made and the market has been announced.
- 10 **agree** for the release of this paper to be delayed beyond 30 business days if necessary until the regulations are in place and a licence to operate a financial product markets has been issued, to minimise any potential commercial risks.

Authorised for lodgement

Hon Dr David Clark

Minister of Commerce and Consumer Affairs

Appendix 1

Updated proposed conditions on licence

Operating condition

Under this licence Catalist may operate only the Catalist Public Market.

Clearing and settlement arrangements condition

Catalist must have and maintain at all times adequate and effective clearing and settlement arrangements for transactions effected through the Catalist Public Market.

Enforcement of Market Rules condition

Catalist must have and maintain at all times adequate and effective arrangements for enforcing compliance with the Market Rules.

Further conditions

- 1 Catalist must apply the following Market Capitalisation limits and parameters to all issuers (i.e. irrespective of whether the issuer is holding public or restricted auctions):
 - 1.1 To be eligible to list on Catalist Public Market, an issuer's initial Market Capitalisation must not exceed NZ\$60 million.
 - 1.2 Once listed, an issuer's Market Capitalisation must not exceed NZ\$100 million.
 - 1.3 A two-year transition period will apply for issuers that exceed this level, i.e. once the NZ\$100 million Market Capitalisation is reached, an issuer will have two years to exit the market. In exceptional circumstances, Catalist may grant a waiver in accordance with its Market Rules, after Catalist has consulted with the FMA in relation to such waiver and taken their response into account.

This condition will be subject to review by the FMA within 24 months of the commencement of any activity covered by this licence.

- 2 Catalist must have adequate arrangements to ensure that, before a retail investor first acquires a financial product on the Catalist Public Market, the retail investor has been provided with information on the nature of the Catalist Public Market and how it differs to a continuous trading exchange, and the risks associated with investing on a market designed for small and medium-sized businesses.
- 3 Prior to commencement of any activity covered by this licence, Catalist must receive written confirmation from the FMA that it is satisfied with the final technology solution.

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- 4 Within 6 months of commencement of any activity covered by this licence, Catalist must provide the FMA with independent verification of the key aspects of the system functionality for executing, running, and settling market transactions, and on the accuracy and integrity of the automated trading functions.
- 5 Catalist must have at least one experienced independent director on Catalist's Board.
- 6 The compliance assurance functions for Catalist Public Market, whether insourced or outsourced, must have a direct reporting line to the Catalist's Board provided that the majority of the Board are independent. If the majority of Catalist's Board of directors is not independent then the compliance assurance functions must instead have a direct reporting line to an independent director.
- 7 Catalist must have a dedicated regulatory and compliance resource to further strengthen its conflicts management when the Catalist Public Market exceeds its initial year trading projections as notified to the FMA at the time of licence application.
- 8 Catalist must comply with the provisions contained in the Regulations, and the exemptions specific to Catalist.
- 9 In relation to the Catalist Public Market, Catalist shall at all times ensure that the FMA has been given notice of the person the FMA should contact in the first instance about any matters arising.