MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

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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Impact Summary: Assessment of regulations under the Financial Markets Conduct Act 2013 for 'MyCap Markets'

Section 1: General information

Purpose
The Ministry of Business Innovation and Employment (**MBIE**) is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing policy decisions to be made by Cabinet about regulatory changes to enable MyCap Markets Limited to operate a new financial product market called 'MyCap Markets Main Market' (**MyCap**). This market is intended to be a 'stepping-stone' market targeted primarily at small growth companies. It would be open to companies seeking equity or debt finance, and to small managed investment schemes. It is meant to be low cost and simplified (more straightforward compliance requirements), with a periodic trading model (where trading on the market occurs during predetermined time windows). Under section 316 of the Financial Markets Conduct Act 2013 (the **Act**) the Minister of Commerce and Consumer Affairs may issue a financial product market licence. The Minister has been advised by the FMA to issue a licence, subject to certain conditions. For the market to operate as intended, regulations will need to be made under the Act to modify the requirements that otherwise apply to financial product markets. These regulations will: • Create new (or alternative) disclosure requirements, which would allow for periodic disclosure (to align with periodic trading), rather than continuous disclosure which is the default position in the Act. • Reduce financial reporting requirements for firms that are subject to a higher standard of financial reporting and auditing only because they are listed on MyCap. For completeness, we note that if this market proceeds, the Financial Markets Authority (the **FMA**), the regulator, intends to use its powers under the Act to issue exemptions from certain other regulatory requirements. These exemptions will exempt issuers on the market from "regulated offer" requirements, including issuing a "Product Disclosure Statement" (insert definition), when: • raising $2 million or less capital in any 12 month period; • 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 (limited to $20 million or less in any 12 month period).

Key Limitations or Constraints on Analysis

Costs of continuous disclosure and increased financial reporting requirements

We do not have cost estimates for continuous disclosure requirements

A key part of the problem definition relates to the costs that regulatory requirements (disclosure and financial reporting requirements) may impose on small firms.

We understand that complying with continuous disclosure requirements is costly. It requires issuers to have internal governance systems to identify relevant information, and they may also need to seek legal advice in order to determine what information must be released. Feedback from consultation indicated that these costs are somewhat fixed, and may not scale well to small firms. We understand that this may be an impediment to listing for small growth companies. However, we do not have any cost estimates relating to continuous disclosure. Nor do we have clear data establishing whether this does act as an impediment. Our assessment of this is based on consultation feedback and opinion.

We do not have cost estimates for financial reporting and auditing requirements

Equally, we do not have cost estimates relating to the increased financial reporting requirements that apply if you are an "FMC reporting entity". If you are an "FMC reporting entity", you are subject to a higher standard of financial reporting and auditing. The most material difference is the requirement for financial statements to be audited by an FMC licensed auditor (as opposed to an auditor that is not licensed under the Act). There are only a small number of FMC licensed auditors. We understand that this increases the costs of an audit to a reasonable degree, but do not have cost estimates.

Cost of proposed periodic disclosure regime and reduced financial reporting requirements

The proposed regulatory changes in this RIA are to allow for a periodic disclosure regime and to reduce the financial reporting requirements for firms listing on MyCap.

We do not have cost estimates (or reductions) for periodic disclosure

We do not have cost estimates or reductions that will result based on these changes.

In theory, periodic disclosure should be less costly because it reduces the points at which issuers will need to consider this. While they will still require systems to ensure they capture the information they need to disclose, and likely need to obtain legal advice, it will concentrate the periods in which they need to give this focus which may in turn reduce the costs.

We do not have cost estimates for the reduced financial reporting and auditing requirements

Equally, for those who will not be subject to the increased financial reporting requirements, those issuers will still incur costs in relation to the reduced financial reporting requirements that will apply. However, the flexibility to use an auditor who is not FMC licensed should reduce the costs of the audit.

Funding gap for small growth companies and benefit of a 'stepping-stone' market

It is widely understood that there is a funding gap for small growth companies seeking capital in the $2 to $10 (or $20) million range, and that it may not be worthwhile seeking this amount of capital from public markets given the costs associated with that. However, we do not have hard data on this. Instead this is informed by anecdotal information.

The anticipated benefit of making regulatory changes to support a “stepping-stone” market is that it will provide increased opportunities for small growth companies to seek public funding, particularly in the $2 - $10 (or $20) million range. We are not able to quantify this benefit, because it will depend on why companies are currently unable to access this funding, and whether the features of this market address the problems they are facing.

The NXT market aimed to address some of the impediments (one of which was considered to be continuous disclosure) to small growth firms seeking public capital. That market did not attract a significant number of small growth companies, and no longer exists. At the time the NZX chose to move from three equity markets (which included NXT) to one equity board, it said that feedback had been that three separate markets and rule sets was overly complex, and that the differences between the markets and rules were not sufficient to make a meaningful difference to compliance costs for issuers. The replacement disclosure regime on the NXT market may have been one of the areas that contributed to the level of cost for issuers, because we understand that also proved to be onerous. However we do not have further insight to this.

Responsible Manager:

Authorised by:

Sharon Corbett

Financial Markets Policy

Ministry of Business, Innovation and Employment

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

Background and current situation

Financial product markets (e.g. exchanges such as NZX) are regulated under the Financial Market Conduct Act 2013.

One of the specific purposes of the Act is to promote fair, orderly and transparent financial product markets. This encourages investors to transact on the market and businesses to raise capital using the market. At the same time, the Act is intended to encourage a diversity of markets to take account of the differing needs and objectives of issuers and investors.

Under the Act, the Minister of Commerce and Consumer Affairs is able to grant a licence to operate a financial product market. The FMA has advised the Minister to issue a licence for MyCap Markets to operate a new "stepping stone" market, MyCap, subject to certain conditions. To ensure that the market does act as a stepping-stone market, available primarily to small growth companies, the Minister intends to impose the following conditions on the market relating to the size of issuers:

- only issuers with an initial market capitalisation of $60 million or less are eligible to list on the market; and
- issuers whose market capitalisation subsequently exceeds $100 million have a two year period to transition off the market.

The size thresholds at which these conditions are set reflect a judgment about the size of company that may count as a small growth company, and which may wish to publicly list on a stepping stone market (and, in a number of cases, may not publicly list today). They also reflect a judgment about the maximum size of company who should benefit from the regulatory changes.

The upper size threshold recognises that companies should be able to grow on the market, before they are required to transition off it, ideally to the NZX. $100 million market capitalisation is also often cited as a figure below which companies may be reluctant to list (although there are a number of companies listed on the NZX below that size threshold). The recent report by Capital Markets 2029 (an industry-led group formed to identify ideas to improve and grow New Zealand's capital markets) noted that they had received feedback that listings of companies with less than $100 market capitalisation receive little support from traditional brokers and investment banks, who seem less willing to support or sponsor such smaller-scale listings.

The Act sets out the general obligations and requirements for those who operate financial product markets, and those who list financial products on them. Relevantly, these requirements include:

- obligations for issuers on the market to continuously disclose material information as it arises; and
- increased financial reporting and auditing requirements for every listed issuer.

Continuous disclosure requires issuers on that market to notify the market of all events or matters that are material to the prices of quoted financial products as they arise. This means those transacting on the market at any given time have access to up-to-date material information about the company. The onus is on the issuer to assess the materiality of

information, and release it immediately to the market. The purpose of it is to ensure that investors can make informed investment decisions, and that financial products are traded at prices that accurately reflect their value.

The reason that increased (and more rigorous and definite) financial reporting and auditing requirements apply to those listed on markets is that there is a higher degree of public interest in these companies. These requirements therefore provide an appropriate level of public accountability.

However, to allow for diversity of markets, the Act also provides flexibility to change the general obligations that apply for particular types of markets through regulations. The regulation-making power specifically provides for the ability to:

- provide replacement or modified provisions to apply in respect to the licensed market – for example, periodic disclosure instead of continuous disclosure provisions; and
- provide that persons do not become "FMC reporting entities" (which means increased financial reporting and audit requirements) only by virtue of being listed on a specified licensed market, and providing for replacement or modified requirements to apply relating to accounting records and financial reporting.

What is the problem?

The general obligations that apply to financial product markets, and the issuers on them, impose clear cost on issuers, and the degree of cost is not necessarily scalable to the size of the issuers.

It is widely understood that there is a funding gap for small growth companies in the $2 million to $10 (or $20) million range, and that it may not be worthwhile seeking this amount of capital off public markets given the costs associated with that. This means that small companies may not be able to access the capital they need to grow, or may try to access it through private markets, which may have more limited pools of available capital. It also means these investment options may not be generally available to retail "Mum and Dad" investors.

Separately, the requirement for continuous disclosure makes sense in the context of markets which trade continuously. However, it makes less sense for markets with a different model, for example, one which only allows for periodic trading as MyCap is intended to operate.

What is causing the problem?

The disclosure and financial reporting and audit requirements are set out in the Act and will apply to financial product markets, and issuers on those markets, unless regulatory changes are made by government. This is not something that companies are able to resolve themselves.

2.2 Who is affected and how?

The main impact of these regulatory changes will be to MyCap Markets (and it may have some precedent effect for anyone wanting to run an equivalent market at a later time), and to potential issuers on MyCap, specifically small growth companies.

By changing elements of the disclosure and financial reporting requirements for those who may list on MyCap, it is hoped that smaller growth firms will be able to list on public markets. These firms may currently be private firms. They may also be firms who sought money through crowdfunding.

While NZX (the only existing licensed financial product market based in New Zealand) is supportive of a stepping-stone market, it did raise concerns about ensuring a level playing and ensuring there are no unfair competitive advantages granted as part of the process. While the intention of the stepping-stone market is to support small growth firms who would not otherwise be able to publicly list, there is some risk that the style of market that MyCap is offering, with periodic disclosure, may appeal to some of the smaller firms on NZX.

Some of the smaller issuers on the NZX would fit within the size caps that will apply to issuers on MyCap. Based on the market capitalisations of companies listed on the main board, we estimate this number to be approximately 55 issuers (which includes both companies and managed funds) on the Main Board, out of approximately 143. However, the volume and value of shares traded for these issuers accounts for a much smaller proportion of overall trading on the NZX. We are unable to estimate the number of listed debt issuers it might apply to, because they do not provide a market capitalisation.

Even though some companies on the NZX could potentially list on MyCap, we do note that there are clear benefits for firms from being on the NZX, including continuous trading and a much wider investor base. Further, this market is intended to be a 'stepping-stone' for companies who might want to list publicly on the NZX, which is a benefit to the NZX. That is why conditions would be attached to the licence imposing controls on the size of companies that are able to list on the market, and when they must move off the market.

2.3 Are there any constraints on the scope for decision making?

The proposed changes to disclosure and financial reporting requirements can only be achieved by regulations made under the Act.

The Act provides the parameters for, and scope of, decisions that can be made. These include, for example, having regard to the purposes of the Act, the nature and size of the market, and likely investors, and ensuring that any exclusions are no broader than necessary.

Section 3: Options identification

3.1 What options have been considered?

Criteria

The criteria we have used to analyse options are based both on the purposes of the Act, and on broader policy goals. These are to:

- maintain the integrity and reputation of our capital markets, and investor confidence, including by ensuring low levels of market misconduct;
- ensure information available on the market will allow efficient pricing of financial products traded, accurately reflecting value; and
- reduce the costs and difficulties of listing for small growth companies and related funding gap, and increase the number and range of investment opportunities for retail investors.

Options

Option one: make no change to the default regulatory settings

This option would involve making no regulatory changes.

This would mean that the default regulatory settings would apply (full continuous disclosure and full financial reporting and audit requirements) to the market, and the issuers on it, if the market went ahead on these terms.

Option two: make changes to the default regulatory settings

This option would involve making the following changes to the default regulatory settings.

Periodic disclosure

Make regulations to provide for an alternative disclosure regime. This would still require the disclosure of "material information". However, this disclosure would only need to take place prior to, and during, each window of trading (an auction), rather than on a continuous basis. The frequency of periodic disclosure will depend on the frequency of the auctions, which will be determined by the issuer. For example, these auctions may take place once or twice a year, or more frequently than that.

These alternative disclosure provisions would be Part 5 market provisions under the Act. This means breach of these provisions may give rise to civil liability under the Act, providing the FMA with an equivalent range of enforcement options for breaches of the alternative disclosure requirements as they have for continuous disclosure.

Reduced financial reporting and audit requirements

Make regulations to reduce financial reporting requirements for firms that are subject to a higher standard of financial reporting and auditing only because they are listed on a licensed market. This is done by providing that issuers are not "FMC reporting entities" (and therefore subject to higher requirements), simply because they are listed issuers on this market. They will be "FMC reporting entities" however, if they are caught for one of the other reasons in the Act.

If they are not "FMC reporting entities" on this basis however, they will be required to meet financial reporting requirements for large companies under the Companies Act 1993, and these would need to be audited (but not by FMC licensed auditors).

Approval of an electronic transfer system

As part of this option, the Minister intends to provide advice to Cabinet that an electronic

transfer system be approved under the Act (which would need to be granted by Order in Council). This enables share ownership to be transferred electronically, which allows the market to operate more efficiently. Without this system, share ownership would need to be transferred manually.

A variation on this second option would be that it includes the changes to allow periodic disclosure, but not the changes to financial reporting and auditing requirements. The reason we have included both elements in this option (and discounted including an option with the periodic disclosure changes only), is that we consider both sets of changes are important in order to reduce the costs that will apply to small growth companies. While we do not have information about the relative cost of these elements, we understand that the cumulative compliance costs with listing are an impediment. Both disclosure and financial reporting and auditing costs contribute to this.

Assessment of options

Assessment of option one:

The applicant is of the view that the market would not be able to viably operate without a modified regulatory regime, particularly if changes are not made to allow periodic disclosure. We, and the FMA, agree with this assessment. On that basis, our assessment of this option assumes that the market would not proceed.

Maintain the integrity and reputation of our capital markets, and investor confidence, including by ensuring low levels of market misconduct

New Zealand's capital markets would operate as they currently do, without a new stepping-stone market, and so the integrity and reputation of our capital markets would be the same as the status quo.

Ensure information available on the market will allow efficient pricing of financial products traded, accurately reflecting value

New Zealand's public licensed markets would operate as they currently do, without a new stepping-stone market, which means that continuous disclosure would apply to all listed issuers. This ensures comprehensive information is available to the market, on a continuous basis, and would allow the financial products to be traded at a price accurately reflecting their value. However, it would also mean that some companies may continue to trade privately, where there would be more limited information disclosure.

Reduce the costs and difficulties of listing for small growth companies and related funding gap, and increase the number and range of investment opportunities for retail investors

The costs and difficulties of listing for small growth companies would not be reduced, because the existing requirements would continue.

There would also be no reduction to the funding gap for small growth companies, if one of the reasons for this gap is the costs associated with publicly listing. Equally, it would mean that there is no change to the existing number and range of investment opportunities for retail investors if small growth companies choose not to list because of the costs associated with that.

Assessment of option two:

As we set out above, when issuing the licence, the Minister intends to impose conditions relating to the size of issuers that may list on this market. While these conditions are not specifically part of this option, they have nevertheless informed our analysis of it.

Maintain the integrity and reputation of our capital markets, and investor confidence,

including by ensuring low levels of market misconduct

Allowing for periodic disclosure, instead of continuous disclosure, is a move away from international best practice. Continuous disclosure allows investors to make informed investment decisions, which enhances investor confidence, while also minimising risks of market misconduct. All of this contributes to the integrity and reputation of our capital markets, and a move away from that may carry some risks.

However, we consider those risks to be low. This regime would still require the disclosure of "material information". The only difference would be in the timing, which is that disclosure would only be required before and during each auction, as opposed to continuously. Given the market will only trade on a periodic basis, we think that this is appropriate. While there may be cases of trading off market, where up to date information is not available, investors will be aware that they are trading at a time where that may be the case.

Further, the broader requirements and protections for licensed markets (such as insider trading, and market manipulation provisions) will apply here which should ensure low levels of market misconduct.

We do not consider that the changes to the financial reporting and audit requirements will have a negative impact on the integrity and reputation of our capital markets or to investor confidence. Any issuer who does not qualify as an "FMC reporting entity" because of these changes will still have to provide comprehensive financial information, and that information will be audited, just not by an FMC licensed auditor. We do not think this makes a material difference.

Ensure information available on the market will allow efficient pricing of financial products traded, accurately reflecting value

It is possible under a periodic disclosure regime that the total amount of information provided to investors may be reduced (for example, if there is material information between trading that is no longer material before and during the auction). However, we consider that the requirements to disclose all information that is material before and during each auction should allow financial products to be traded at a price that accurately reflects their value.

If someone chooses to trade off-market it is possible that they would trade at a time when they do not have up-to-date information. However, they will know this is the case. It is not clear how much off-market trading would occur.

However, it is possible that some companies will move to this market from private trading. In those cases it is likely that more information will be disclosed, allowing for more efficient pricing of financial products.

Reduce the costs and difficulties of listing for small growth companies and related funding gap, and increase the number and range of investment opportunities for retail investors

This option should enable small growth companies to list on a licensed market more cheaply and easily by reducing some of the requirements (with associated compliance costs) that apply.

By making changes to allow for a publicly traded market accessible to small growth companies it is possible that the funding gap will be reduced, and small but growing New Zealand firms will have better and easier access to growth capital. This would also increase the diversity of New Zealand based investment options. The degree to which this is successful however, depends on the reasons why they are not able to access capital today, and whether this market addresses those impediments.

3.2 Which of these options is the proposed approach?

We consider that option two is the best option.

By providing for periodic disclosure, and changing when an issuer is subject to increased financial reporting requirements, this reduces the costs associated with listing and ensures that the requirements make sense for the periodic style of trading this market will operate under.

This will hopefully provide the opportunity for some small growth companies to list, who otherwise would not have due to the compliance burden and costs. It may also assist them to grow and transition towards listing on a continuously traded exchange such as the NZX.

There are some risks involved with this form of market. These include a reduction in the amount of information about issuers on the market, and any related impacts this may have on the integrity of our capital markets, and the efficiency of products traded over those markets. MBIE believes that the risks are low, and that the potential benefits outweigh them.

There is no incompatibility with the *Government's 'Expectations for the design of regulatory systems'.*

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties *(identify)*	**Comment**: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action		
Regulated parties	There would be no additional costs to the market operator compared to the status quo from these regulatory proposals. Equally, there should be no additional costs to issuers (small companies, or managed investment schemes) to the status quo from these regulatory proposals. Any costs will only be incurred if issuers choose to issue, and they are expected to be lower than the costs they would incur if they had to comply with all regulatory obligations (if no regulatory changes were made).	None
Regulators	There will be some cost to the FMA in overseeing the proposed new market and proposed new approach for disclosure. This includes monitoring costs, and any potential enforcement action. This cost may be higher at the beginning, when the market operator is new, and the issuers less experienced. However, it may come down over time.	Low
Wider government	N/A	
Other parties	There may be some cost to the NZX, if any smaller issuers choose to list on MyCap instead. However, there are clear benefits to being on the NZX. Equally, MyCap is intended to be a 'stepping-stone' to full listing, so the NZX may benefit from this.	None to low.
Total Monetised Cost	Without accurate quantifiable evidence, it is difficult to provide an estimate.	Not known
Non-monetised costs	Given the costs will depend on how many issuers list, and whether they are listed on public markets today or not, we only see a small increase in cost.	Low

Expected benefits of proposed approach, compared to taking no action		
Regulated parties	MyCap Markets will benefit from being able to run a 'stepping-stone' market. This market may also benefit small growth companies and small managed investment schemes, if it removes some of the impediments they currently face to listing on a public market, they choose to list, and succeed in raising capital.	Low-Medium
Regulators	N/A	
Wider government	N/A	
Other parties	There may be some benefit to the NZX, if companies choose to transition from MyCap to the NZX. There may also be some benefit to investors in New Zealand if it increases the number of good investment opportunities open to the public. If this increases the number of funding options for firms in New Zealand, and allows them to grow, this could also have flow on public benefits from job opportunities and economic growth.	Low
Total Monetised Benefit	Without accurate quantifiable evidence, it is difficult to provide an estimate.	Not known
Non-monetised benefits	Providing opportunity for small growth companies to list. Actual benefit will depend on the numbers who choose to list.	Low (but dependent on number of companies)

4.2 What other impacts is this approach likely to have?

In the future, some small growth companies who might have listed on NZX's main board, or smaller issuers already listed on NZX's main board, may list on the new market instead. If that new market is operating without continuous disclosure this might impact on perceptions of New Zealand's disclosure regime on listed markets, both within New Zealand and by international observers.

If this market is licensed, and goes ahead with the regulatory changes, this may set a precedent for future markets. However, each market would be considered on its own merits, taking into account the particular features of that market.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

MBIE, alongside the FMA, engaged in a targeted consultation exercise with:

- A partner at a large law firm.
- A partner at boutique law firm specialising in small company capital raising.
- A large brokerage and investment firm.
- The New Zealand Shareholder's Association.
- An early stage investment fund.
- The External Reporting Board.
- A licensed crowdfunding provider.
- The NZX.
- An exempt unlicensed market.
- NZVIF.
- Capital Markets 2029.
- The Institute of Finance Professionals New Zealand.

Responses to the market proposal were generally positive and supportive of the proposed regulatory approach. Where discussed, respondents thought New Zealand capital markets were less developed than they could be, and there was some dissatisfaction with existing options.

There was a feeling from existing markets that any concessions open to MyCap should also be an option for them if they met the criteria. However, these regulatory changes are being recommended in the context of a market designed to attract small growth companies, who otherwise would not publicly list.

A number of other specific technical points were raised about the market operations, which will be dealt with through the FMA licensing work.

The FMA were involved and consulted during the policy development process.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
The regulations supported by this RIS will be created under the Act, and will come into effect after the market is licensed to operate. We expect the market to come into operation in the first part of 2020. Before that happens, the FMA will work with the MyCap to approve its issuer rules, and will also grant the exemptions. The FMA will have primary responsibility for monitoring and regulating the market. This is a core regulatory function.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
All market operators are obligated to provide an annual report to the Minister each year setting out how they have met their regulatory obligations. The FMA will monitor the market, and the issuers on the market. The long term impact will be apparent if companies move from MyCap onto the NZX. We will have visibility over this.

7.2 When and how will the new arrangements be reviewed?
The licensing conditions relating to size will be reviewed in two years. Aspects of the market will need to be reconsidered in five years when the FMA exemptions automatically expire. MBIE will consider the role of the market, and will review the regulatory arrangements if that is believed to be necessary.