

25 March 2010

Mr Liam Mason
General Counsel
Securities Commission of New Zealand
8th Floor,
Unisys House,
56 The Terrace,
Wellington 6011

Dear Mr. Mason

NZSX Listing Rule Review 2010

In April 2009, the Commerce Minister approved emergency measures in the wake of the global financial crisis, including changes to the NZSX listing rules. The Commerce Minister requested a review of these listing rule changes within 12 months. We welcome this review as we believe it essential, post the crisis, to reassess the changes made and we thank you for your invitation to provide input.

The conditions faced by the global markets in late 2008 and early 2009 were extraordinary and required New Zealand business, regulators and investors to react to the abrupt tightening of access to capital for New Zealand companies. Investors and businesses were generally supportive of the NZSX changes that were designed to address unnecessary disclosure and reduce processing times.

However, some of the changes removed or weakened the requirement to gain shareholder approval for activities which typically need investor oversight. As a result there has been a substantial increase in board power and weakening of protections against related party participation, presenting new risks for investors in New Zealand companies.

Reputational issues for New Zealand markets

A key priority for the Securities Commission is to ensure investors can have confidence in New Zealand's securities markets so that the markets can increasingly attract investment from New Zealand and overseas. A market's reputation for corporate governance directly impacts cost of capital. If international and local investors believe shareholder protection in New Zealand has weakened, this could have a negative impact on New Zealand companies and investors.

We should therefore take note of concerns raised by RiskMetrics Group (RMG), a leading international corporate governance advisory firm for large institutional investors, including the Guardians.

RMG's "New Zealand Governance: State of Play" report last year states:

"The changes to the listing rules have potentially far reaching consequences for investors in NZ companies because of the characteristics of NZ's equity markets. They also carry potential risks for investors especially given the relaxation of limitations on security issues to directors, transactions with related parties and reduced protection against dilution."

Alignment with ASX

The changes to the NZSX rules on share issues, director placements and related parties introduced new disparities with the ASX rules. We believe it is better to align the ASX and NZSX rules where this reinforces good corporate governance. Aligning the rules also supports the recommendation by the Capital Markets Development Taskforce to encourage Australian investors to run AUS-NZ portfolios. Disparities can present a problem for dual-listed companies seeking to apply consistent standards to Australian and New Zealand investors.

NZSX 2009 Rule changes

The OECD Principles of Corporate Governance and International Corporate Governance Network standards are widely recognised as international standards and are appropriate benchmarks for the NZSX. We refer to these standards in our comments below on specific 2009 rule changes:

1. Raising the threshold of shares that can be issued in a private placement without shareholder approval from 15% to 20% (changes to rule 7.3.5 a)

The ICGN guidelines¹ state that shareholders should approve the issue of significant portions of new shares. The change to this threshold increases the potential for existing shareholders to be diluted. The ability of a board to place 20% of the capital with whom they choose requires extra scrutiny by regulators to ensure the fair and transparent operating of the market for control. Analysis of the last 12 months shows that the new NZSX 20% threshold was rarely used during the financial crisis. This indicates that the pre-existing cap of 15% was not overly restrictive on companies.

We recommend reinstating the 15% threshold for share issues without shareholder approval.

2. Allowing participation of directors or associated persons in placements without shareholder approval (changes to rule 7.3.5 b).

Requiring shareholder approval for share placements to directors is consistent with best practice and in line with the ASX rules. Shareholder approval is an important protection since placements to directors or related parties can be open to abuse. We do not believe a certificate signed by Board members affords sufficient protection to investors. We have little evidence to show that placements to directors provided a

¹ ICGN Global Corporate Governance Principles 8.3.3

quick source of capital in difficult markets. Post the crisis we do not believe there is any justification to retain this change to the rules.

We recommend that shareholder approval is required for participation of directors or their associates in placements and that the exemption under Rule 7.3.5 for director participation in placements be removed.

3. Participation of directors in employee share schemes (rule 7.3.9)

The OECD Principles for Corporate Governance² state that “the equity component of compensation schemes for board members and employees should be subject to shareholder approval.” We support the change to listing rule 3.5.1 allowing remuneration in shares subject to shareholder approval. We do not support the changes to rules 7.3.6 and 7.3.9 which allow executive directors (and associated persons) to participate in employee share schemes without shareholder approval. Given executive directors hold powerful positions in companies, it is important that shareholders have the opportunity to approve such share-based remuneration. Poorly structured share schemes can work against the long-term interests of the company and its shareholders. Share schemes can be routinely approved at the Annual Meeting of Shareholders (AGM).

We recommend that shareholder approval is required for allowing directors, including executive directors and their associates, to participate in employee share schemes.

4. Raising the allowable threshold for material related party transactions which can take place without shareholder approval from 5% to 10% of the company’s market capitalisation (changes to rule 9.2.2)

We view any long-term relaxation of the threshold on related party transactions as increasing risk to shareholders of abusive practices, particularly in markets like New Zealand where there is a high exposure to related parties and major shareholders. Significant related party transactions should be subject to a vote by non-conflicted shareholders³. Related party transactions can result in a transfer of value to the related party to the detriment of the company and its shareholders. We do not believe it is in the long-term interests of the New Zealand market and investors to relax controls on related party transactions.

We recommend reinstating the 5% threshold for material related party transactions allowable without shareholder approval.

5. The amount of financial assistance an entity may provide its employees to purchase shares increased over 12 months (increased from 2% to 5% mkt cap) and five years (increased from 5% to 10% mkt cap).

Providing financial assistance for share purchases to employees, directors and associates exposes the company and its investors to the risk that loans will not be repaid, particularly when share prices fall. Increasing the materiality threshold

² OECD Principles of Corporate Governance Section 2 II C.3 (see also ICGN Principle 5.7)

³ Ibid. 1

increases this risk to investors. Approval for exceeding limits on financial assistance can be sought from shareholders at the AGM. Without strong evidence to the contrary, we see little burden to companies in managing these loans within the previous rules.

We recommend that the amount of financial assistance an entity may provide its employees to purchase shares without shareholder approval reverts to 2% market capitalisation over 12 months and 5% of market capitalisation over five years.

Conclusion

Investors and companies benefited from the 2009 changes to the listing rules where these removed unnecessary reporting and improved efficiency. We have focused on the changes that have reduced shareholder protection in the market. These rules were broadly emergency measures and post the crisis we believe they should revert to the pre-crisis rules. Typically, it is not onerous to bring a resolution to the AGM and very rarely do shareholders vote against well thought through proposals and remuneration packages. Such controls and disciplines increase transparency, deter market abuse and help protect the reputation of the New Zealand market as a whole.

Yours sincerely,



Neil Williams
General Manager Public Markets
Guardians of New Zealand Superannuation

cc Adrian Orr, CEO, Guardians of New Zealand Superannuation
cc Tim Mitchell, General Manager Corporate Strategy, Guardians of New Zealand Superannuation