

29 May 2015

NZX Limited
PO Box 2959
Wellington

Attention: Hamish Macdonald, NZX Head of Policy

By email: consultation@nzx.com

Dear Mr Macdonald

NZX review of NZ Markets Disciplinary Tribunal penalties

Thank-you for the opportunity to provide comment on the NZX *Review of penalties available within NZ Markets Disciplinary Tribunal Rules and Procedures: Discussion Document*.

We appreciate that the NZX is seeking feedback on a number of proposals and ideas to ensure the penalties regime is fit for future purpose. We look forward to continued engagement with the NZX as any proposals for change are developed.

By way of general comment, the Institute of Directors in New Zealand (IoD) considers legal compliance to be fundamental to governance best practice. One of the ways a board adds value is by ensuring the probity of financial reports and processes and a high standard of compliance with regulatory environments.

Liability is imposed on directors under various acts and regimes and it is important to ensure balance so that compliance and liability/penalty regimes do not become so onerous that they deter directors from putting themselves forward to serve on boards of publicly listed companies and of other organisations.

About the Institute of Directors

The IoD is a non-partisan voluntary membership organisation committed to raising governance standards in New Zealand. We represent a diverse membership of about 7,000 members drawn from NZX-listed corporations, unlisted companies, private companies, small to medium enterprises, public sector organisations, not-for-profits and charities. Our chartered membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good corporate governance.

Commentary on the discussion document

We comment on a number of proposals and ideas put forward in the NZX discussion document in this submission.

Are current maximum penalties sufficient?

Penalties applied between 2010 and 2014 (as shown in the discussion document appendices) were mostly in the lower bands. The Tribunal's 2014 report shows that nine of the 18 penalties were below \$10,000, and the two highest penalties were \$100,000 (Diligent - periodic reporting) and \$150,000 (Fonterra – disclosure re potential botulism).

We consider that the current maximum penalty of \$500,000 is sufficient.

Proposed new penalty bands

NZX proposes replacing the existing 8 penalty bands with 3 new broader bands (for both issuer and market participant breaches):

1. **Minor** breaches (minor compliance failings with no material market or shareholder/client impact) – fines up to \$50,000
2. Breaches of **medium** severity (more than just minor compliance failings and potential for material market or shareholder/client impact) – fines up to \$100,000
3. **Serious** breaches (intentional breaches or significant compliance failings with material market or shareholder/client impact) – fines up to \$500,000

We do not object to the proposed change to 3 penalty bands on the basis that it will enable the Tribunal to have more consistent treatment of categories of breaches and to better deal with overall conduct, including systemic compliance failings.

However it is not clear how the penalty limits for bands 1 and 2 have been arrived at, in particular why a penalty range of up to \$50,000 is needed for minor breaches in band 1. As a high proportion of current fines are at the lower end of the spectrum it is not clear why fines of up to \$50,000 would be needed for minor compliance failing with no material impact.

While the maximum penalty of \$500,000 for band 3 ('serious breaches') aligns with the current maximum penalty, we suggest NZX ensures the maximum penalties for bands 1 and 2 align with current maximum penalty levels that apply for breaches that would fall into those 2 bands. For example a maximum penalty of \$20,000 may be sufficient for band 1 - 'minor breaches with no material impact.'

In addition we would be concerned if the new band structure was used to increase the levels of penalties awarded as that is not the rationale put forward in the discussion document for the 3 band structure.

Consideration of different markets, eg NXT

As noted in the discussion document (page 3) the Tribunal considers breaches of NZX Participant Rules, NZX Listing Rules, NXT Market Rules, NZX Derivatives Market Rules, Clearing and Settlement Rules of New Zealand Clearing Limited and Fonterra Shareholders' Market Rules.

However it is not clear from the discussion document if/how the penalties review has considered different markets, for example the new NXT market, and whether any differentiation has been considered, or is warranted, for this penalty regime.

Public censure

NZMDT Rules and Procedures currently allow NZX to seek (at their discretion) public censure of an issuer or market participant (including directors or officers by name) in relation to breaches.

Public censure of directors and officers is a serious matter and can have a significant effect on personal reputation. Accordingly, directors and officers should have the ability to defend themselves if they face potential naming. To not allow this would contravene principles of natural justice and could also deter directors from taking on governance roles with issuers.

Should NZX introduce financial penalties for directors?

Although directors and officers of issuers can be identified/named in relation to breaches, NZX cannot impose financial penalties on them.

NZX says it "has received feedback that it might be appropriate for the Tribunal to impose financial penalties on directors or officers in respect of issuer breaches" (page 12).

We do not see any need for NZX to introduce financial penalties for directors and officers in respect of issuer breaches.

There are already significant existing obligations and liabilities for directors under the Companies Act, Financial Markets Conduct Act and other legislation. We also note that NZX has not presented any particular rationale for introducing financial penalties for directors and officers in the discussion document. And as NZX notes the ASX is not able to impose penalties on directors of issuers (although ASIC and the FMA both can).

Further we agree with NZX that fining directors could "act as a disincentive for individuals to participate in the management and governance of listed issuers".

Should NZX introduce infringement notices?

We note that NZX is considering introducing an infringement notice regime for dealing with minor breaches with fines capped at \$10,000 or \$20,000. There would be no automatic right to a hearing before the Tribunal.

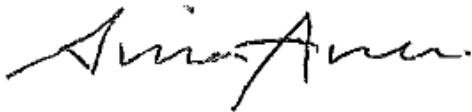
It is not clear to us that there is a need for this development. The introduction of infringement notices could also enable an increase in the number of penalties awarded for minor breaches in a potentially unfettered manner.

If NZX does introduce infringement notices they should be for minor breaches with fines capped to cover the existing level of fines for minor breaches (e.g. \$10,000 may be sufficient) and there should be a right of appeal to the Tribunal.

Conclusion

The IoD thanks the NZX for the opportunity to make a submission on behalf of its members. We would be happy to discuss this submission and we look forward to continued engagement with NZX on any proposed changes to the penalties regime.

Yours sincerely

A handwritten signature in black ink, appearing to read "Simon Arcus".

Simon Arcus
Acting CEO and Manager, Governance Leadership Centre