

7 June 2019

Capital Markets 2029 Review
Steering Committee Secretariat
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Feedback on Capital Markets Review

The Institute of Directors (IoD) appreciates the opportunity to contribute its views and feedback on the Steering Committee's [Capital Markets 2029: Have your say](#) document. This industry-led review of capital markets in New Zealand was initiated by the Financial Markets Authority and NZX. The purpose of the review is to deliver a ten-year vision and growth agenda for the sector with more people and companies involved in capital markets to build opportunity and wealth for New Zealanders. We welcome the review and encourage more frequent opportunities for stakeholders to contribute their views on capital markets.

There has been considerable change in New Zealand's capital markets in the last ten years including significant governance related developments. The IoD has contributed to a number of these developments including the new NZX Listing Rules, the NZX Corporate Governance Code and the FMA's Corporate Governance in New Zealand: Principles and Guidelines.

The IoD's feedback focuses on director and governance related issues. Notwithstanding our comments here, the IoD would be pleased to make further comments as the review progresses.

About the Institute of Directors

The IoD is a non-partisan voluntary membership organisation committed to driving excellence in governance. We represent a diverse membership of over 9,000 members drawn from listed issuers, large private organisations, small and medium enterprises, state sector organisations, not-for-profits and charities.

The IoD's *Code of Practice for Directors* provides guidance to directors to assist them in carrying out their duties and responsibilities with high professional standards. All IoD members sign up to the Code.

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.

Invitation for feedback

The Committee has invited feedback across a range of areas and we have focused on matters arising from the "Regulatory considerations" section, including:

- disclosure obligations for listed entities
- short-termism
- the balance of risk between investors, issuers, directors and other stakeholders involved in the capital markets
- Directors & Officers insurance and
- facilitating access to talent.

IoD comments

The IoD supports moves to improve the vibrancy of New Zealand's capital markets and the aim of increasing opportunity and wealth for New Zealanders.

We also highlight that New Zealand is ranked first by the World Economic Forum's *Global Competitiveness Report 2017/18* for the efficacy of its corporate boards and for the ethical behaviour of its private institutions. The 2019 FM Global Resilience Index also ranks New Zealand second out of 130 countries for corporate governance. New Zealand's financial services sector is also generally considered to be well regulated.

Disclosure obligations

IoD supports transparency and appropriate disclosure obligations for listed entities. However, additional or more onerous obligations can result in too much time spent by directors and managers on compliance rather than performance.

In our 2018 [Director Sentiment Survey](#), 41% of directors said regulatory red tape was a key barrier to economic performance. In addition, 71% of directors said they spent more time on compliance related activities than in the previous year. This is related in part to receiving more information on financial and non-financial risks (including on culture and conduct, health and safety, digital, cybersecurity and climate issues).

The IoD was disappointed that the contentious issue of constructive knowledge was included in the new NZX Listing Rules. We hope our concerns about adverse effects of this change won't materialise such as increased compliance costs and insurance premiums, the risk of hindsight bias, boards becoming more risk averse, and the possibility of deterring directors from serving on listed companies.

Short-termism

Boards have a fundamental role in setting, driving and overseeing an organisation's strategy. They must be continually engaged in strategic matters to ensure the long-term sustainability of those organisations. This is particularly important in today's complex and challenging operating environment.

However, investor demand for short term results can undercut those goals. Entities need to curb the forces of short-termism influencing corporate conduct and culture, and good corporate governance is critical to this. It can help entities strike the right balance between making short, medium and long-term time horizons.

We note that media attention (including social media) can magnify and, in some cases, manipulate the public's focus on bad news over good. This short-termism leaves less time for directors to prepare for, and shape, the future. Its perils in a more general context have been highlighted recently by the Governor of the Reserve Bank,¹ and the Securities and Exchange Commission in the United States has also announced a roundtable to consider short-termism and public companies.²

Should New Zealand develop a stewardship code?

We note that many jurisdictions have investor stewardship codes. Investor stewardship codes are designed to improve the quality of engagement between investors and companies, strengthen corporate governance, and promote long-term profitability. Codes recognise that large shareholders

¹ "Shaping Futures National Conference", speech to the Financial Services Council, Auckland, 7 September 2018.

² SEC Media Statement May 2019: <https://www.sec.gov/news/public-statement/clayton-announcement-short-long-term-management-roundtable>

have a responsibility to engage with boards in a constructive way and to not pressure a company to deliver short-term results. They are often voluntary, and usually apply to institutional investors. Many countries have stewardship codes in place including the United Kingdom (which is currently being reviewed), Hong Kong, Japan and South Africa. Australia's first compulsory stewardship code was introduced in 2017 by the Financial Services Council which represents the country's fund management and pension industry. In the United States, the Framework for US Stewardship and Governance came into effect in January 2018. This includes stewardship principles for investors, and corporate governance principles for listed companies.

It would be timely to consider developing a stewardship code in New Zealand and we would welcome the opportunity to contribute to it.

Balance of risk

The IoD agrees that effective capital markets balance risk appropriately between investors, issuers, directors and other stakeholders.

It is critical that boards attract well qualified, experienced directors to maintain the standard of governance, and trust and confidence in capital markets in New Zealand.

Directors are already exposed to significant liability in their roles, an exposure that has been increasing over time across legislative and regulatory regimes (eg in relation to health and safety). There are several further proposals to extend director personal liability, including under the Credit Contracts and Consumer Finance Act and within the Conduct of Financial Institutions review.

Being a director already carries a high level of reputational risk along with responsibility. There are a number of examples in New Zealand and Australia in the last 12 months where directors have faced significant public scrutiny when things have gone wrong in their organisations.

We encourage government and regulators to take a holistic view of board and director responsibility. We are very concerned that increased regulation, coupled with personal liability for directors, will discourage well qualified people from joining boards, distract from long term business goals and dampen innovation. Any agenda for the capital markets should avoid changes to the regulatory framework that risk those outcomes.

There is also a risk that founders/directors of private companies will avoid taking companies public given the increased public scrutiny and high risk profile.

D&O insurance

The review document notes that appropriately priced D&O insurance, including specific cover for capital raisings, is becoming a challenge due to the burgeoning class action environment for listed companies in Australia. Other factors that have contributed to the turbulent D&O insurance market include:

- the board's roles and responsibilities have expanded over recent years
- policy-makers continue to target directors for personal liability in reforming regimes
- regulators are more active and well-funded (such as the FMA and the Commerce Commission)
- there has been substantial court awards against directors and organisations
- litigation funding is prevalent, and there are activist law firms (appearing and organising their own claims) and liquidators pursuing directors with sizeable D&O policies / personal assets.

The cost of Directors and Officers insurance generally has risen markedly in recent years and is prohibitive for some organisations. The Australian Law Commission noted increases of more than

200% in the 12 to 18 months to June 2018,³ and we are aware that the percentage is considerably higher for some organisations. This is very concerning and such costs will ultimately reduce shareholder returns.

Facilitating access to talent

The Report of the Capital Market Development Taskforce 2009 recommended allowing employers to more easily obtain work visas for the offshore staff that they wished to hire. In our 2018 [Director Sentiment Survey](#), 61% of directors identified a tight labour market as a top barrier to national performance (up from 46% and 54% in 2016 and 2017 respectively). Concerns about workforce skills and capability feature strongly in the survey with the largest proportion of directors (28%) identifying it as the biggest risk facing their organisation. Access to talent is a long standing issue, and we are aware that there are a number of national reforms/initiatives underway related to talent and the future of work (eg those involving the Future of Work Tripartite Forum and the Prime Minister's Business Advisory Council). It is essential that the Steering Committee connects in with these reforms/initiatives, while also considering potential regulatory reform to facilitate access to talent.

Conclusion

It is important to have an agenda to deliver more vibrant capital markets with more opportunity and wealth for New Zealanders. Directors will play a vital role in the implementation of any such agenda and they should be at the heart of its design. However, to ensure success, the regulatory framework within which directors operate must continue to attract the right people and support them to focus on long term strategy, appropriate risk taking and enduring shareholder value.

We appreciate the opportunity to comment on behalf of our members and would be happy to discuss our feedback with you.

Yours sincerely



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³ Australian Law Commission Reform, *Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (June 2018).