

23 October 2023
Kristin Brandon
Head of Policy and Regulatory Affairs
Email: kristin.brandon@nzx.com

RE: NZX Capital Raising Settings Consultation and Guidance Note

Dear Kristin,

Thank you for identifying the New Zealand Corporate Governance Forum (**NZCGF** or the "**Forum**") as a key stakeholder in relation to the recent review of the NZX's Capital Raising Settings.

The Forum is committed to promoting good corporate governance of New Zealand companies for the long-term health of the capital market. We believe that good governance improves company performance and increases shareholder value, which is a core focus for NZCGF members as custodians of capital.

We acknowledge NZX's efforts in undertaking a review of Capital Raising Settings and NZX's constructive engagement with the NZCGF in response to our advocacy on this issue. We provide the following feedback on the Consultation Response Paper (**Response Paper**) and the draft Capital Raising Guidance Note (**Guidance Note**).

While we recognize that the Financial Markets Authority has approved the proposed changes under the Financial Markets Conduct Act 2013, we nonetheless wished to respond with some brief comments on the Response Paper:

1. The Response Paper acknowledges the Forum's proposition that Accelerated Non-Renounceable Entitlement Offers (ANREOs) can have harmful impacts for shareholders, in the form of value transfers. The Response Paper specifically contemplates the dilution impact these offers can have on shareholders who do not / cannot participate.
2. We acknowledge that NZX is proposing significant limitations on the use of ANREOs to minimise the extent of dilution and better protect shareholders who do not / cannot participate.
3. We do, however, note that the value transfer may be material as the rules do not limit the discount of the issue price to the current price, and there is no effective limit on shareholder dilution as multiple pro-rata ANREOs could be undertaken by an Issuer over any period. We suggest that NZX consider imposing a limit on total dilution resulting from ANREOs over any 12-month period be capped at 1 share for every 3 shares at the beginning of the period. We note that the Listing Rules limit placement and Share Purchase Plan (SPP) capacities (without shareholder approval) on a 12-month periodicity.
4. We agree with NZX's observations that the quality, and rigour, of disclosures regarding the choice of offer will be critical, to ensure that shareholder interests are properly considered when structures are selected.
5. The Response Paper lists a range of situations where submitters have suggested ANREOs may be in the interests of the company and shareholders generally. However, in many of these situations it seemed to us that other offer structures could be used which better reflect shareholder rights and market integrity.

6. While NZX appears to accept that ANREOs should be used only in limited circumstances, the proposed regime authorises them generally so long as the Issuer provides the requisite disclosure. We consider that this creates a risk that they become much more mainstream than the policy analysis supported. Therefore, we request that NZX / NZ Regco closely monitors the use and impact of ANREOs to ensure that they are implemented in appropriate circumstances – we consider “appropriate” means that the choice of structure provides benefits to shareholders as a whole group (see paragraph 11 below). We also suggest that the Guidance Note records that ANREOs are only likely to be appropriate in narrow situations where there is a compelling and well evidenced basis to believe that it is in the best interests of shareholders.
7. As an aside, we note that in our market interactions with advisors there is often significant emphasis placed on ANREOs achieving less dilution than other offer structures, and the draft Guidance Note also gives this factor prominence as a possible reason that an ANREO or non-pro rata offer structure may be justified. As noted in our white paper titled *Capital Raisings: The Forum’s Perspective* and dated 24 August 2022¹, issuers tend to focus on the relative discount to market price, which may be less for a non-pro-rata offer. However, this may be overly simplistic, in that for a renounceable pro-rata offer the discount will not impact existing shareholders in the same manner since they can sell rights, whereas in a ANREO the discount results in direct dilution/cost to non-participating shareholder. Hence, NZX and/or NZ Regco should ensure this does not become an over weighted driver as to the choice of offer structure.
8. It appears that many submitters, including broker firms, have referred to the reduction in underwriting fees arising from ANREOs. We note that while the cash fees may be reduced (it appears to us that this would require analysis of what the fees would have been under an alternative pro-rata structure, and we have not seen supporting data or evidence), the true underwriting cost to all shareholders is obscured by the absence of recognizing the direct value transfer from non-participating shareholders to underwriters. We suggest that NZX ensures disclosures include all underwriting costs and that costs are compared to costs under equivalent pro-rata structures.
9. NZX should undertake a post implementation review after 18 months to ensure that market changes and disclosure practices have occurred in line with NZX’s intent in the Response Paper.
10. In the Guidance Note we consider that greater emphasis, especially in guidance on the choice of structure and the appropriate disclosures supporting non-pro-rata offers, should be placed on the benefits to shareholders as a whole group (vs pro-rata equivalents).
11. The Guidance Note recognises that under the revised Listing Rules that pro-rata renounceable offers are permitted without shareholder approval, and without any limit on the amount of capital that can be raised. We believe that the Guidance Note should more explicitly caution (or temper) its enthusiasm for the large-scale use of such offers, in the context that such offerings should always be undertaken in the interests of shareholders. Such a capital raising is arguably a ‘major transaction’ (i.e. significant change to the Issuer’s capital structure), with material impacts on current shareholders.
12. The suggestion in the Guidance Note that Boards should prefer allocating “(where possible) to investors who are likely to be medium to long term investors in the Issuers, rather than short term investors (such as hedge funds)” when assessing the impact of a capital raising on the overall composition of the share register could be clarified. If the Guidance Note is referring to allocations of excess shares to new investors (i.e. not current shareholders) then this should be made explicit. If the Guidance Note is referring also to allocation among existing shareholders, then it appears at odds with directors’

¹ Please see our website www.nzcgf.org.nz for a copy.

duties to act in the best interests of financial product holders generally (or, speaking more plainly, fails to appropriately recognize the duty of directors to the current shareholders of the issuer, and to treat all those shareholders equally).

13. In the Guidance Note discussion on disclosures, NZX should note that the specified items are only minimum disclosures and issuers may wish to provide more comprehensive information to shareholders. As regards disclosures relating to ANREOs, we believe that NZX should avoid making any comments on acceptable grounds for issuers selecting such offer structures. It could be perceived that the NZX is indicating acceptable grounds, and our desire would be to avoid a market practice where grounds are taken as justified by 'being in the Guidance Note' regardless of the circumstances or context. As per paragraph 10 above, we would like the Guidance Note to emphasize the need for disclosures which provide support that the offer structure selected by the issuer is in the best interests of shareholders as a whole group, when compared to alternatives.
14. The Guidance Note contemplates that the 'independent' advisor who is advising on the appropriate offer structure can have another role in the offer, such as lead manager or underwriter of the raise. We suggest that, as a minimum, the Guidance Note records that boards should be conscious that underwriters would have an inherent conflict that boards need to consider given their financial interest in undertaking the underwriting and the different benefits that accrue to the underwriter under different offer structures. For instance, in an ANREO there is (in addition to the cash underwriting fee) a transfer of value from the shareholders who cannot or do not participate to the underwriters.
15. We consider that the commentary on waivers should recognise that the effect of granting a waiver is for NZ Regco and the directors to transfer to themselves important approval rights that would otherwise be held by shareholders. Further the decision of a board to apply for a waiver should be driven by the board's view that the granting of the waiver is in the interests of shareholders (as a whole group) and disclosures should substantiate this view.

We would like to see NZX emphasize that Issuers should be constantly thinking about their liquidity position and the risk associated with their current capital structure. We believe that the indicated frequency of NZ RegCo granting waivers should be reduced from "very unlikely" to "extremely rare", and for the Guidance Note to rule out the use of such waivers to raise capital for asset purchases, mergers and other major and material transactions. We consider that waivers should be applied for / granted under emergency, e.g. when the Issuer faces imminent demise. We recall and refer you to our letter titled *NZX Major and Related Party Transactions Guidance Note* dated 24 February 2023 for further details.

* * *

Once again, we welcome the opportunity to provide feedback on NZX Capital Raising Settings Consultation and Guidance Note and acknowledge NZX's constructive engagement with the NZCGF in response to our advocacy on this issue.

Please note that individual Forum members may make their own submissions directly to NZX, and this submission will be published on our website (www.nzcgf.org.nz) and LinkedIn page.

Yours sincerely,

Sam Porath
Chair
NZ Corporate Governance Forum