FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

Response to submissions:

Going Public – a director's guide

February 2015

About the FMA

The FMA is an independent Crown entity with a mandate to promote and facilitate the development of fair, efficient and transparent financial markets. We work with financial markets participants to raise standards of good conduct, ethics and integrity, and to achieve best standards of practice and compliance.

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Response to submissions on 'Going Public – a director's guide'

Consultation process

We issued the 'Consultation Paper: Going Public – a director's guide' on 17 November 2014. The aim of the guide is to help directors assess whether going public is the right choice for their company and to provide an insight into the process of becoming a public company.

As a result of our consultation, we received six written submissions from a variety of market participants including professional bodies, investor relations consultants and legal advisers. The full list of these submissions is contained in the appendix of this document.

We would like to thank all the submitters for their constructive feedback and the general support shown for the approach taken to this guide. We have made changes to the consultation draft in response to these suggestions.

Key themes from submissions

The following is a summary of the key themes from submissions.

1. Intended audience and director's legal obligations

Several submitters queried what the intended audience of the guide was and whether it should be more specific about the legislative requirements for directors in relation to IPOs.
We intend the guide to be a short introduction for directors to the process of becoming a public company and to note the important questions directors should consider. While we have made changes to the guide to better reflect certain aspects of the law, we do not consider it appropriate for the guide to be a comprehensive account of the legal requirements for directors in relation to the IPO process. As stated in the guide, directors will need to select professional advisers to help them understand these details.

2. Understanding the company's business

One submitter believed the guide should not imply that a company is required to implement the list of factors identified in paragraph 4 before an IPO. We have made it clearer that these are simply matters for directors to consider when they are deciding whether their company should undertake an IPO.

3. Appointment of directors prior to an IPO

Some submitters stated that it was commonplace for issuers to appoint directors close to an IPO listing and that this is generally appropriate and reasonable for a variety of reasons, such as meeting the minimum number of independent directors required for a listed public company. While we do not agree that it is generally appropriate to leave appointment of new directors until just before the IPO, we recognise that it may be necessary in certain circumstances for directors to be appointed close to an IPO listing. We have

revised the guide to state that directors should ensure they have sufficient time and access to sufficient information so they adequately understand the company's business and its risks before the IPO.

4. Role of the legal adviser

One submitter believed it was not a material attribute of the legal adviser, in the context of an IPO process, to represent the issuer's intentions in negotiations with other parties. However, another submitter argued for more emphasis on a legal adviser's ability to advocate clearly and effectively on behalf of the board. We agree that the ability to represent the board's interests robustly in negotiations with other parties (including with other advisers and with management) is an important role of the legal adviser in relation to an IPO.

Some submitters suggested that providing the board with guidance on how to design an effective due diligence process for an IPO was also an important role of the legal adviser. We agree with this and have included it in the guide.

5. Role of the auditor

One submitter commented that it was not the role of the auditor to help explain issues to investors, as it was not their statutory duty and could raise issues of independence. We have made changes to clarify that the auditor should be able to explain complex issues to directors which will in turn ensure investors have access to reliable financial information to help their investment decisions.

6. Role of the advisory accountant

Some submitters stated that one of the key roles of the advisory accountant is to help the board test any prospective financial information that may be included in the offer documents. We agree and have included this point in the guide.

7. Communications adviser

Some submitters requested that we include a communications or investor relations adviser in the list of key advisers and service providers. While we do not believe a communications or investor relations adviser is essential to the IPO process, we agree they may play a significant role in helping directors bring their company to market and have included words to that effect.

8. The due diligence process

Some submitters did not agree with the proposition that due diligence would be more effective in protecting directors from legal liability if it was designed and implemented to verify the accuracy of information provided to investors, than if it was designed with director or adviser liability in mind. For instance, one submitter stated that the two objectives are aligned, and the due diligence process design would not be different if one objective was prioritised over the other.

We have made changes to make it clear that we are encouraging directors to focus on the substantive aim of an effective due diligence process, which should be to identify issues and ensure the adequacy and accuracy of information provided to investors. With this core objective in mind, a well- designed and implemented process will also more effectively protect directors from legal liability if there is an allegation of defective disclosure.

Several submitters commented that the guide should emphasise that directors, and independent directors in particular, should be members of the due diligence committee. We agree and have included this in the guide.

Some submitters noted that key management and advisers should not be members of the due diligence committee, or should participate as observers or advisers only. Further, some submitters did not believe the distinction between members of the due diligence committee and those who attend as observers or advisers to be 'largely artificial' as was stated in the guide.

We believe that membership of due diligence committees should be based on a person's ability to ensure that information for investors meets the required standards. Directors need to satisfy themselves that that their due diligence committee has the right mix of skill and experience to achieve this objective, and this may include key management and advisers. However, references to the distinction between members of the due diligence committee and those who attend as observers or advisers being 'largely artificial' have been removed.

9. Pricing

One submitter believed it was not appropriate for the FMA to be advising directors about pricing. This is not our intent. Rather, we are trying to ensure directors take an active and robust role in the price-setting process for newly issued shares, rather than simply deferring to the judgement of the lead managers. Even when a 'book build' process is used, there is not typically an IPO clearing price— rather a range of potential pricing outcomes from which the directors must select an appropriate price. While this price will be heavily determined by the advice provided by the lead managers, directors must satisfy themselves that the trade-offs they are making between the IPO price and aftermarket performance of the shares are in the best interests of existing shareholders.

One submitter commented that IPOs can be structured in a number of ways that would result in the directors of the company not setting the price of the shares. In addition, the standard setting the price, as referred to in paragraph 23 of the guide, was inconsistent with section 47 of the Companies Act 1993, which provides that where the directors resolve to issue shares, the price must be fair and reasonable to the company and to existing shareholders. We have revised the guide to note that the price of the shares will not always be set by the directors of the issuer (ie, where only existing issued shares are sold) and have aligned the price-setting wording in the guide with the provisions of section 47 of the Companies Act 1993.

Identifying areas of change in the final publication

Where appropriate, we have incorporated comments from each of the above-mentioned key themes in the revised version of the guide. The revised "Going Public – a director's guide" can be downloaded here.

You can contact us at:

Phone: 0800 434 567

Email: consultation@fma.govt.nz

Appendix A: List of submitters

1. Bell Gully
2. Merlin Consulting Limited
3. Minter Ellison Rudd Watts
4. Russell McVeagh
5. The Institute of Directors in New Zealand
6. The Public Relations Institute of New Zealand