



JUNE 2021

# Regulatory Impact Statement

## Exemptions for Catalist Markets listed issuers for same class offers and small offers

This document is for issuers listed on Catalist Markets, their advisers, and other interested parties. It discusses exemptions to enable Catalist listed issuers to make 'same class' offers and small offers of \$2 million or less through the market.

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# Executive summary

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This Regulatory Impact Statement (RIS) discusses exemptions to enable issuers listed on the Catalyst Public Market, a new licensed financial product market, to make 'same class' offers and small offers of \$2 million or less through the market. Issuers will be exempt from 'regulated offer' requirements, including issuing a product disclosure statement (which provides investors with key information).

We think the exemptions will help facilitate the development of an innovative growth market that has the potential to offer small growth companies more funding options at an earlier stage in their growth cycle. This may help to address a funding gap within New Zealand's capital markets. It may also increase the number of investment opportunities available in New Zealand.

This RIS summarises the problem we are seeking to address, our objectives, the options and their associated impacts, and the consultation process we undertook before deciding to grant the exemptions. Our analysis of whether to grant the exemptions was based on the statutory test that applies to use of the FMA's exemption powers. We must be satisfied that the exemption would promote one or more of the purposes of the Financial Markets Conduct Act 2013 (the **FMC Act**). We must also be satisfied that the extent of the exemption is not broader than reasonably necessary to address the matters that gave rise to the exemption.

## Exemption granted

After careful consideration of both regulatory and non-regulatory impacts, we decided to grant a class exemption to enable Catalyst Markets listed issuers to make 'same class' offers and small offers of \$2 million or less through the market. The exemption will be subject to conditions outlined in this RIS.

# Background and issue

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## Funding gap

It is widely accepted that New Zealand has a funding gap in its early stage capital markets for small growth companies in the \$2 million to \$10 million (or \$20 million) range. It is considered that it may not be worthwhile seeking to raise capital in this range from public markets given the costs associated with that. This has implications for start-up companies as they seek capital to grow, and more broadly on the depth and strength of our capital markets. Deeper capital markets promote growth opportunities for individual firms and increase the number of opportunities available for investment, including by retail investors. They also promote economic growth by more effectively channelling capital to its most productive use.

## The FMC Act allows for different markets with tiered requirements

Part 5 of the FMC Act has a stated objective to “encourage a diversity of financial product markets to take account of the differing needs and objectives of issuers and investors”. This objective was developed in response to a recommendation made by the Capital Markets Development Taskforce. The Taskforce recommended that exchanges could be developed with a lower regulatory burden than existing exchanges, and that such ‘growth’ or ‘stepping stone’ markets might support the growth of firms by lowering the cost of capital-raising and creating a pathway between private and public equity funding.

## New ‘stepping stone’ market

On 31 May 2021, the Minister of Commerce and Consumer Affairs granted a licence to Catalist Markets Limited (the **market operator**) to operate a new ‘stepping stone’ market, Catalist Public Market, subject to certain conditions. This includes conditions limiting the size of issuers who can use the market, which will mean that:

- only issuers with an initial market capitalisation of \$60 million or less are eligible to list on the market
- issuers whose market capitalisation subsequently exceeds \$100 million have a two-year period to transition off the market.

The market is targeted primarily at small growth companies looking to raise growth capital (of around \$2 million to \$20 million). The market is intended to have lower regulatory costs and simplified compliance obligations than a traditional exchange. It should enable companies to grow on the market before they reach a size where they are required to transition off it. Companies may then choose to graduate onto a major exchange like NZX.

The market will operate as an online platform for financial products on which trading occurs only during periodic auctions, as opposed to continuous trading as conducted on traditional exchanges such as NZX. The auction frequency will be set by each issuer and could take place monthly, quarterly, or yearly. A periodic disclosure regime would apply, with a requirement to disclose material information by the start of and during each auction, but not between auctions.

## Regulations are necessary for the market to operate as intended

Changes to how the general obligations in the FMC Act apply to the proposed market are required to reflect the periodic trading model. They are also important to ensure that the costs are appropriate for, and do not act as a barrier to, small growth firms listing on public markets.

Regulations have been made to provide for:

- alternative disclosure requirements allowing for periodic disclosure (to align with the periodic auctions) rather than continuous disclosure; and
- modified financial reporting requirements to apply to Catalist Markets listed issuers, so that issuers will not be subject to a higher standard of financial reporting and auditing only because they are listed on Catalist Public Market.

## Market operator seeks exemptions for same class offers and small offers

### Exemption for same class offers

#### ***Existing same class offers exclusion***

The market operator seeks an exemption equivalent to the 'same class offers' exclusion in clause 19 of Schedule 1 of the FMC Act (**same class offers exclusion**). This enables offers of financial products of the same class as products quoted on a New Zealand licensed market to be made, without the disclosure normally required under Part 3 of the FMC Act (eg a product disclosure statement (PDS)). This exclusion has been well utilised by NZX issuers, allowing significant amounts of capital to be raised efficiently.

The same class exclusion recognises that for existing financial products quoted on licensed markets, there is timely, accurate and understandable information publicly available to investors. For quoted products, there is already information available relating to price and trading history. The price and trading history will reflect publicly available information, and continuous disclosure and financial reporting requirements ensure that all relevant information is in the public domain. The current price and trading history (extending to at least three months before quotation) provides investors with up-to-date information about the value of the quoted financial product (and therefore the value of the product of the same class being offered). This assists investors – in lieu of a PDS – to make confident and informed investment decisions.

#### ***Issue***

The same class offers exclusion cannot be used by Catalist Markets listed issuers because the Catalist market rules do not contain continuous disclosure provisions, as required by the exclusion.

## Exemption for small offers

### ***Existing exclusions for small offers***

The market operator also seeks an exemption equivalent to existing exclusions that permit small offers of \$2 million or less to be made without the disclosure normally required under Part 3 of the FMC Act.

The small personal offers exclusion in clause 12 of Schedule 1 of the FMC Act (**'small offers exclusion'**) permits issuers to raise \$2 million in any rolling 12-month period provided this is limited to 20 investors, is not advertised, and a warning statement is given. The policy intent of the exclusion is to increase the ability of small companies to raise capital.

The exclusion for offers through licensed intermediaries (eg equity crowdfunding and peer-to-peer lending platforms) in clause 6 of Schedule 1 of the FMC Act (**'CF/P2P exclusion'**) permits issuers to raise \$2 million in any rolling 12-month period through licensed equity crowdfunding and peer-to-peer lending platforms. The policy rationale is to support the ability of small companies to raise capital and support innovation. The lack of disclosure requirements for issuers is mitigated by the continuing application of the fair dealing provisions of the FMC Act, and by the platforms being licensed and subject to a number of initial and ongoing requirements under the Financial Market Conduct Regulations 2014 (**'FMC Regulations'**).

### ***Issue***

The 20-investor limit and advertising restriction that applies to the small offers exclusion limits the ability of Catalist Markets listed issuers to use this as a means of publicly raising growth capital. Catalist Markets listed issuers also cannot use the CF/P2P exclusion because this only applies to offers made through equity crowdfunding or peer-to-peer lending platforms.

# Objectives

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In some instances where market participants encounter difficulties offering financial products under the standard FMC Act regime, exemption relief from a regulatory or disclosure requirement may be appropriate. Any exemptions we grant must promote one or more of the purposes of the FMC Act. Additionally, the extent of the exemption must not be broader than reasonably necessary to address the matters that gave rise to the exemption.

In considering the use of the FMA's exemption powers, we assessed options against the following objectives, which we consider are the most relevant purposes of the FMC Act for this matter:

- to promote and facilitate the development of fair, efficient, and transparent financial markets
- to promote the confident and informed participation of businesses, investors, and consumers in the financial markets
- to provide for timely, accurate, and understandable information to be provided to persons to assist those persons to make decisions relating to financial products or the provision of financial services
- to promote innovation and flexibility in the financial markets
- to avoid unnecessary compliance costs.

We assessed the possible options against these objectives. In doing so, we considered the interests of stakeholders including:

- consumers
- Catalist Markets listed issuers
- the market, and other exchanges and platforms.



# Options and impact analysis

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We considered two options in relation to each problem identified:

- Option 1 (selected): Grant exemptions
- Option 2 (not selected): No exemptions (status quo)

## Option 1: Grant exemptions

### Description

Grant exemptions for issuers listed on Catalist Markets to facilitate:

- same class offers of Catalist Markets-quoted financial products
- small offers of \$2 million or less.

The exemptions would mean these offers can be made without the disclosure normally required under Part 3 of the FMC Act (eg a PDS). The offer would not be a 'regulated offer', which means Part 4 governance requirements would also not apply.

The exemptions would be available to companies listed on Catalist Markets that have a market capitalisation that does not exceed \$100 million. This aligns with the size cap that will be imposed by Catalist Markets' licence conditions. Holders of a listed company's financial products will also be exempt when selling those products.

The exemptions would be subject to requirements and conditions that are consistent with the requirements of the same class offers exclusion (for the same class offers exemption), and the small offers exclusion and CF/P2P exclusion (for the exemption for offers of \$2 million or less). Some modifications would be made to apply the exclusions to this market – for example, to reflect the periodic nature of trading and disclosure on Catalist Markets. Please see the schedule to this RIS for more details of the exemption requirements and conditions.

### Impact analysis

#### ***Promotes innovation and flexibility in the financial markets***

Granting the same class offers exemption is one of the key regulatory changes required for the market to operate as proposed. The exemption would facilitate the development of an innovative growth market and be consistent with the FMC Act Part 5 objective of encouraging a diversity of financial product markets.

***Promotes and facilitates the development of fair, efficient, and transparent financial markets and avoids unnecessary compliance costs***

Providing issuers with relief from regulated offer requirements (eg preparing a PDS) should facilitate the potential for the market to act as a viable option for small companies to raise capital at low cost. Feedback indicates that regulated offers have a high fixed cost that is imposed regardless of the amount being raised, which means that full regulation is disproportionate and a barrier to smaller offerors. The exemption would remove this barrier to small companies listing and raising capital publicly, assisting them to grow and to access capital appropriate to their stage of development. This encourages increased participation in capital markets and may assist to address the capital-raising 'gap'.

However, we do not have firm data on the costs for a small growth company to undertake a regulated offer compared to undertaking private capital raising, equity crowdfunding (for small offers), or raising capital through the market. Our assessment is based on data relating to regulated offers undertaken by larger issuers, consultation feedback and anecdotal information. We are also not able to quantify the benefit of small companies having increased opportunities to seek public funding through the market, because this will depend on why these companies are currently unable to access this funding, and whether the features of this market address this.

The exemption for small offers would provide an additional capital-raising 'pathway' by enabling issuers to initially raise up to \$2 million via the market under the exemption. Issuers could then make follow-on offers using the same class offers exemption, or by using the small offers exemption to raise up to \$2 million on an annual basis. However, the target issuers may wish to raise more than \$2 million in growth capital relatively soon after joining the market. This means that while the exemption may be useful for some issuers, it may not be heavily used.

***Promotes the confident and informed participation of businesses, investors, and consumers in the financial markets***

Facilitating capital raising by small growth companies has the potential to provide investors with access to wider investment opportunities. Using a licensed market may give investors more confidence to invest in small companies; for example, because this offers (in theory) an ability to exit. However, the growth opportunities for issuers and increased investment opportunities need to be balanced against preserving investor confidence in financial markets and ensuring investors have sufficient information to make investment decisions (see next section).

***Provides for timely, accurate, and understandable information to be provided to persons to assist those persons to make decisions relating to financial products or the provision of financial services***

The periodic trading/disclosure model means investors will not be able to monitor information disclosed continuously over time and observe consequent pricing trends and trading history, as they would for offers made under the same class offers exclusion. For the same class offers exemption, this creates an increased risk, compared to the same class offers exclusion, of reduced transparency and that investors will not be as informed. If investors feel they are not adequately informed this could affect investor confidence and market efficiency.

To help address this risk, the exemption would be subject to conditions that seek to ensure investors are in a position to make confident and informed investment decisions. This includes requirements for the financial products to have been quoted for at least three months and for at least three public auctions to have been held. The exemption for small offers would require issuers to display a warning statement to investors, and takes into account the requirements that apply to the licensed market operator under Part 5

of the FMC Act and its conditions of licence. Additionally, issuers will be required to disclose all material information to investors prior to making a same class offer or a small offer.

## Option 2: No exemptions (status quo)

### Description

We would not grant the exemptions for same class offers or small offers.

### Impact analysis

The market operator has stated that the same class offers exemption is fundamental to the success of the market and the market proposal would not proceed without this. This means an opportunity to facilitate an innovative growth market which could assist to address the capital-raising gap for small growth companies would be lost.

If we granted the same class offers exemption but not the exemption for small offers, this would remove a potential pathway for issuers to initially raise capital on the market but otherwise should not have any material impact.

## Summary assessment of options against objectives

**KEY:** ✓✓ Meets the policy objectives   ✓ Partially meets the policy objectives   ✗ Does not meet the policy objectives

	Option 1: Exemption (preferred)	Option 2: No exemption (status quo)
<b>Promote and facilitate the development of fair, efficient, and transparent financial markets</b>	Granting the exemptions would remove a barrier to small growth companies seeking public capital and assist them to grow and access capital appropriate to their stage of development. If successful, this may assist to address the capital-raising gap for small companies. It may also provide a pathway for small companies to transition to full public markets. ✓✓	Without the exemptions, small companies are likely to continue to rely on private capital rather than listing on a full exchange or making a full regulated offer. This would continue the current environment where barriers to small companies raising capital creates inefficiencies in allocating capital and reduced investment opportunities, impacting the strength and depth of our capital markets. ✗
<b>Promote confident and informed participation of businesses, investors, and consumers in the financial markets</b>	Granting the exemptions may assist to increase the number and range of investment opportunities available for public investment. Facilitating this to occur through a licensed platform may give investors more confidence to invest in small growth companies and to participate in this type of market; for example, by potentially providing increased information, price transparency and liquidity than OTC trading or private markets. ✓✓	As above, this would continue the barriers to small companies listing and raising growth capital on public markets, which may reduce participation of small companies in our capital markets and reduce investment opportunities for investors. ✗
<b>Provide for timely, accurate, and understandable information to be provided to persons to assist those persons to make decisions relating to financial products</b>	Unlike the same class offers exclusion, the periodic trading/disclosure model means investors will not be able to monitor information disclosed continuously over time and observe consequent pricing trends. If investors feel they are not adequately informed this could affect investor confidence and market efficiency. This risk is mitigated by the requirement to disclose all material information prior to making an offer, and exemption requirements and conditions which seek to ensure investors are in a position to make confident and informed investment decisions. ✓✓	Without the exemptions, small companies are likely to rely on (non-retail) OTC trading or private markets which do not have prescribed information requirements. ✗

<b>Promote innovation and flexibility in the financial markets</b>	Facilitates the development of an innovative growth market which may increase the ability of small companies to access growth capital, supporting the objective of the FMC Act to promote innovation and flexibility in the financial markets and to encourage a diversity of financial product markets. ✓✓	An opportunity to facilitate an innovative growth market which could assist to address the capital raising gap for small growth companies would be lost. It may also discourage others from developing similar growth market initiatives. ✘
<b>Avoid unnecessary compliance costs</b>	<p>Compliance costs are often fixed, or unrelated to firm size, so larger issuers pay less proportionate to the benefits they realise from public listing. Small issuers need more flexible, less onerous regimes or they will resort to private capital.</p> <p>Enabling Catalist Markets listed issuers to raise capital without needing to incur the time and monetary costs of undertaking a full regulated offer lowers regulatory burden and removes a barrier to small companies listing and accessing public capital. The costs of full compliance (eg preparing a PDS) are not necessary or justified by the benefit of compliance given the exemption conditions which seek to ensure investors are in a position to make informed investment decisions. ✓✓</p>	The requirement to prepare a PDS and make a full regulated offer to raise public capital would likely deter small growth companies from using the Catalist Public Market. It would likely be more cost effective and efficient to instead rely on private capital. That would avoid compliance costs but would not promote other FMC Act objectives as outlined above. ✓
Not broader than reasonably necessary to address problem	The exemptions apply only to offers made by offerors on Catalist Markets and are subject to issuer and offer size restrictions. The exemptions are granted on a similar basis to existing legislative exclusions, including equivalent limitations and conditions. ✓✓	n/a

- ✓✓ Meets the policy objectives
- ✓ Partially meets the policy objectives
- ✘ Does not meet the policy objectives

# Consultation

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## Consultation approach

We carried out a joint targeted consultation with MBIE on the policy proposals for Catalist Markets, including seeking feedback on the proposed exemptions. We engaged with a range of interested stakeholders including investors, existing operators of other markets and platforms, and advisors. We received feedback from 12 stakeholders.

## Feedback on same class offers exemption

The consultation feedback suggested general support from market participants for the same class offers exemption, as it could increase capital raising and investment opportunities. Submitters commented that:

- The same principles apply as under the existing legislative exclusion, just at a point in time. The requirement to release all material information before the offer would ensure the market is fully informed.
- On the basis that all material information is released prior to an auction there would be sufficient information to make an informed investment decision. The absence of continuous disclosure is not detrimental to investors because there is no continuous trading. This model has an advantage over a continuous disclosure model as investors would have all the information they need in one place, as opposed to the information being spread over time.
- The exemption would materially reduce the cost and time for issuers, compared to preparing a PDS. There would be no negative impact on investors on the basis that the issuer must release all material information prior to offering the new products.

One submitter thought the exemption could increase the risks to investors of inappropriate pricing. Another commented that the market design would need to ensure investors can be confident the clearing prices at previous auctions are a true reflection of supply and demand. The Catalist Markets pricing process works differently to a continuously traded market. During an auction, investors can see the market's assessment of the information disclosed reflected in the indicative closing price for the auction, before any trades are concluded. The Catalist Markets market operator has suggested that this makes historic pricing less relevant.

Some submitters were concerned with ensuring a level playing field. There was a feeling from existing markets that any exemption provided should be available to issuers on other markets if they met the criteria. There was also a sentiment that issuers on this market should not be subject to lighter touch disclosure standards than are permitted for NZX issuers.

The exemption will be subject to requirements that are consistent with the requirements of the same class offers exclusion available to issuers on exchanges with continuous disclosure, including NZX issuers. We will consider applications by other market operators for a same class offers exemption on an equivalent basis to the same class offers exclusion on their merits. Any exemption would need to promote one or more of the purposes of the FMC Act.

## Feedback on exemption for small offers

The stakeholders we engaged with were also generally supportive of the proposed exemption for small offers of \$2 million or less. Submitters commented that:

- The exemption makes sense given that crowdfunding platforms have the benefit of an exclusion for offers under \$2 million and they are more lightly regulated.
- There should be no negative impact on investors on the basis that the issuer must release all material information prior to offering the new products.

Some submitters thought the \$2 million limit is too low. This limit is consistent with the legislative exclusions for small offers and CF/P2P platforms. If the legislative limit is revised in the future, we can consider whether there is a policy case to similarly adjust the limit that applies to the exemption.

One submitter noted that the crowdfunding exemption is available to crowdfunding platforms that are licensed and must meet associated obligations. This submitter thought that a market operator that provides crowdfunding services should be required to hold a crowdfunding licence and the obligations that apply to crowdfunding platforms should apply eg ensuring the information provided is fair and not misleading. We agree that part of the policy justification for the CF/P2P exclusion is that the intermediary services (ie the crowdfunding and peer-to-peer platforms) are licensed and subject to a number of initial and ongoing requirements under the FMC Regulations. In deciding to grant the exemption, we have taken into account that the Catalist Markets market operator is similarly required to be licensed and is subject to initial and ongoing requirements under Part 5 of the FMC Act. The 'fair dealing' obligations under Part 2 of the FMC Act also continue to apply.

# Conclusion and selected option

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Having carefully considered regulatory and non-regulatory impacts, and feedback provided through consultation, we decided that Option 1 (grant exemptions) addresses the identified problems and will achieve the objectives of:

- promoting and facilitating the development of fair, efficient, and transparent financial markets
- promoting the confident and informed participation of businesses, investors, and consumers in the financial markets
- promoting innovation and flexibility in the financial markets
- avoiding unnecessary compliance costs.

Option 2 (no exemptions) would not achieve these objectives and would continue the barriers to small companies listing and raising growth capital on public markets, which may reduce participation of small companies in our capital markets and reduce investment opportunities for investors.

On this basis we have decided to grant exemptions for issuers listed on Catalist Markets to facilitate same class offers of Catalist Markets-quoted financial products, and small offers of \$2 million or less. The exemption will be granted subject to conditions that are consistent with existing legislation exclusions, and will seek to ensure investors are in a position to make confident and informed investment decisions. We think these exemptions will help facilitate the development of an innovative market that has the potential to offer small growth companies more funding options at an earlier stage in their growth cycle.



# Schedule – Exemption requirements and conditions

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## Same class offers exemption

The exemption will be available if all of the following apply:

- The offer is of financial products that are equity securities, debt securities, or managed investment products in a registered scheme; or options and option underlyings that are equity securities, debt securities, or managed investment products in a registered scheme.
- The Catalist market rules must contain alternative disclosure provisions, which will require all material information relating to the financial products to be disclosed by the start of and during each auction period.
- The financial products must have been quoted on the Catalist Public Market for at least three months before the offer is made.
- At least three public auctions allowing trading in that class of financial products must have been held.
- The offer does not result in a breach of the \$20 million limit. This applies a limit of \$20 million on the amount that can be raised by an offeror in any 12-month period.
- No disciplinary action has been taken by the licensed market operator in relation to a failure by an issuer to comply with any Catalist market rules relating to the disclosure of information during the three-month period before the offer is made.

As per the same class offers exclusion, requirements around the product (or option underlyings) remaining quoted after the issue or sale will apply.

The exemption will not apply if the offer is within three months of a backdoor or reverse listing.

The exemption will be subject to the following conditions:

- The issuer must:
  - at the date of the cleansing notice (see below), be in compliance with its alternative disclosure obligations and its financial reporting obligations; and
  - give the licensed market operator a cleansing notice in the 24-hour period before the offer is made (unless the market operator requires it earlier). The cleansing notice must include any material information that has not previously been disclosed to the market (eg due to a waiver), as well as material information about events or matters that arose during the three-month period before the offer is made, including when those events or matters arose.
  - In the case of debt securities, offerors must also give investors a statement containing certain information, including about how investors can obtain information about quoted debt securities that are the same class as those being offered.
- Following the offer, the issuer must provide the Catalist Markets market operator with a notice correcting any defect in a cleansing notice, if it or the offeror (if different) becomes aware of certain defects.

## Exemption for small offers

The exemption for small offers of \$2 million or less will be available if all of the following apply:

- The offer is of equity securities or debt securities.
- The offer is made through the Catalist Public Market and is subject to the Catalist market rules.
- The offer does not breach the \$2 million limit. This means issuers are limited to raising NZ\$2 million in any 12-month period. This cap will apply to an issuer using any combination of this exemption, the CF/P2P exclusion, and the small offers exclusion over any rolling 12-month period.

The exemption will be subject to the condition that the offeror must make a prescribed warning statement available to investors prior to investment. The wording is similar to the warning statements required to be given under the CF/P2P and small offers exclusions.

