



SEPTEMBER 2022

Market operator obligations review

Catalist

Findings from the FMA's review of how well Catalist is meeting its licensed market operator obligations, for the period 21 June 2021 to 31 March 2022

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Executive summary

About this report

Catalist Markets Limited (Catalist) is licensed under section 316 of the Financial Markets Conduct Act 2013 (FMC Act) to operate Catalist Public Market.

The FMC Act requires the FMA to carry out a review and report on how well Catalist is meeting its licensed market operator obligations. We may carry out this review at any time but must do so at least once a year.

This report covers the first market obligations review for Catalist, and covers the period from 21 June 2021, the licence commencement date, to 31 March 2022, the end of Catalist's first reporting period ("the review period").

Catalist provides a platform where small and medium-sized businesses (SMEs) can raise new capital through a public (licensed) market and private markets. Investors can also trade equity and debt securities, and managed investment products through a secondary market.

The Catalist Public Market is aimed at SMEs seeking liquidity or seeking to raise capital up to \$20 million, with a view that once these entities reach a certain scale and size, they would transition on to the next phase of their growth, which may be a listing on the NZX. It was designed to be a lower-cost and simplified financial products market, offering trading by way of an online auction platform with periodic (rather than continuous) trading and disclosure.

How we approached this review

As with other market operator obligations reviews, we selected certain areas of focus. The scope of our review was influenced by this being Catalist's first period of licensed activity, the modest scale of the activity currently undertaken on its licensed market, and the particular conditions of its licence.

The scope of this review focused on, but was not limited to, the following key areas:

- Governance arrangements and oversight
- Resources needed to operate the market
- Monitoring of participants' conduct
- Risk management
- Conflict management
- Arrangements for enforcing compliance
- Arrangements for notifying disclosure

In assessing these areas and overall compliance, we reviewed and considered how Catalist is structured and governed by reviewing establishment documents and charters, protocols and controls, minutes of meetings and risk management frameworks.

We employ a risk-based approach to monitoring, and while this review is of Catalist's overall compliance with its licensed market operator obligations, we have exercised our judgement in selecting focus areas,

and the level and detail of work performed in each. This report highlights our main observations from the review and, as with any risk-based approach, has inherent limitations.

Overall assessment

Our overall conclusion is that Catalist has complied with its licensed market operator obligations during the review period. In making this assessment we considered specific conditions of Catalist's licence and obligations of a licensed market operator under the FMC Act¹, in particular the general obligations under section 314 to:

- do all things necessary to ensure, to the extent that is reasonably practicable, that each of its licensed markets is fair, orderly and transparent
- have adequate arrangements for notifying disclosures made to it under a disclosure obligation, and for continuing to make those disclosures available
- have adequate arrangements for handling conflicts between its commercial interests and the need to ensure its markets operate in a fair, orderly and transparent manner
- have adequate arrangements for monitoring the conduct of participants in its markets
- have adequate arrangements for enforcing compliance with relevant market rules
- have sufficient resources (including financial, technological and human resources) to operate its licensed markets properly.

Observations

Our key observations for the period include the following:

- Catalist has developed governance arrangements, and drafted protocols that have been tailored for its purposes and are relevant to the nature and size of its current activity.
- From the discussions and information gathered, we observed the overall design of Catalist to be well planned, noting the organisation is well placed to naturally expand as business grows.
- From commencement through to the end of the review period, Catalist has maintained proactive engagement with issuers, investors, and the regulator.
- Catalist's technology platform is a modern application that does not suffer legacy issues and is well positioned for growth.

We identified the following matters that require further consideration as Catalist matures:

Area	Observation
Key person risk	Catalist is currently a small team with a high level of reliance on each other's skill sets. Therefore, well-documented policies and procedures, and transfer of knowledge is vital to smooth operations. Given the elevated risk of some staff members playing pivotal roles, we expect continued focus in this area.

¹ Refer to the appendix for further details on obligations

Risk management and conflicts management	Catalist is required to have a dedicated regulatory and compliance resource, which is separate to its commercial function, once the Catalist Public Market exceeds its initial year trading projections as notified to the FMA at the time of licence application. As Catalist has not yet exceeded these projections, the requirement has not been triggered and therefore assessment of such will be undertaken in the subsequent review of Catalist. At present, the Chief Financial Officer (CFO) and the Head of Compliance (HoC) are combined roles, with many risk management activities performed by the CEO. As Catalist matures, we expect further segregation of activities so functions can be given a more tailored focus.
Financial capability and resilience	Catalist has annual budgets and projections for growth, with regular reporting to the Board on the entity's performance against budgets, with regular reviews of projections. Given Catalist is in the initial stages of growth, reviewing and resetting projections is inherently more difficult. As the entity matures, we expect continuous focus on assessing financial capability and resilience to be undertaken by management and the Board.

Focus areas

Governance arrangements and oversight

Background and review

As this was the first period of activity for Catalist, we concentrated our review on the overall structure and governance arrangements, the design of roles and responsibilities, and the level of Board oversight. We reviewed establishment documents, protocols and controls, and minutes of meetings, and held discussions with key staff members and various Board members.

Catalist is currently operating with a small team who bring a range of skills to the organisation. The Catalist Board plays a critical role in challenging and supporting management while ultimately maintaining accountability for ensuring the licensed public market is operated in a compliant and effective manner. This is achieved through setting strategic direction, suitable risk management practices, and sufficient and appropriate levels of oversight².

As part of this review, we considered the variety of experience on the Board, and the organisation's current size and complexity. Catalist has a Board of four directors, representing a range of industry and regulatory knowledge and experience, with three independent Board members.

FMA observations

From the discussions and information gathered, we observed the overall design of Catalist to be well planned, noting the organisation is well placed to naturally expand as business grows. Our review of Board minutes, and discussions with Board members confirmed a good level of challenge and oversight. For example, the Board reviews and challenges every listing before it is accepted by Catalist. We are satisfied with the high level of engagement, and openness of management and the Board to challenge and support each other. We have recommended that all day-day policies and procedures are continually refreshed, and that Catalist considers how else it can mitigate the Key person risk.

Resources to operate the market

As outlined in the FMC Act, under general obligations for licensed markets, Catalist is required to have sufficient resources (including financial, technological and human resources) to operate its licensed markets properly.

² Catalist Board meetings are held once every month, except January.

External technology review

Background and review

In accordance with Catalist's licence, an external technology review was required within six months of commencing any activity covered by the licence. This review was completed by an independent entity. The purpose of this review was for Catalist to provide the FMA with independent verification of:

- key aspects of system functionality for executing, running, and settling market transactions
- the accuracy and integrity of automated trading functions.

No material issues were found during testing carried out as part of the independent review; however, the reviewer made four minor recommendations for Catalist to consider, none of which affected the core functionality.

FMA observations

We considered the independent review and had further discussions with Catalist on the recommendations made. Catalist confirmed that all recommendations had already been implemented. We are satisfied that Catalist met this licence obligation.

Technology capability

Background and review

Catalist has emerged from its development phase and has now entered a growth phase. Given the small size of Catalist, and with no defined product manager role, there is a high degree of cross-functional agility when it comes to technology development. Catalist has a strong focus on lifting maturity as the business grows.

FMA observations

Catalist's technology platform is a modern application designed for its chosen cloud-based platform. It is well architected and follows good design standards. As a new application, it does not suffer from legacy infrastructure constraints or out-of-date software, meaning overall system performance and capacity is well positioned to meet current business needs and future growth.

Catalist has leveraged its cloud-based services to ensure appropriate availability, capacity, continuity, and cybersecurity protection. IT policies and procedures (including external security reviews) are at appropriate levels for its business risk posture.

We note the systems have handled capacity well to date and are set up to manage future volume increases with public auctions. Catalist should continue to develop its IT operations and ensure its standards and procedures are well documented and audited. This should include continuous improvements in business continuity arrangements and risk oversight to match business growth and client expectations. During the review period, there were no material technology issues which would compromise business operations or cause risk to clients.

Financial capability and resilience

Background and review

The Catalist Board maintains oversight of resource allocation decisions including financial budgeting, material changes of approach to technology, and significant human resource decisions. As part of this review, we looked at the audited accounts along with financial projections, reporting to the Board and Board minutes, and held discussions with relevant staff and Board members.

FMA observations

We found through our discussions and review of relevant materials that the Catalist Board maintains good oversight of resource allocation decisions including financial budgeting, material changes of approach to technology and significant human resource decisions.

We note how important financial projections are, particularly in a start-up business, and how uncertain they can be, and understand that Catalist provides the Board with monthly financial reports including forecasted performance against budget and actual cash flows. Given Catalist is in the early stages of growth, and projections are by their nature uncertain – inherently so in a start-up business – it should have continuous focus on assessing financial capability and resilience to be undertaken by management and the Board.

Human resources

Background and review

As part of our review, we considered the adequacy of resources to operate the market. In considering this, we were cognisant of the design of the market, conditions imposed on the licence, and current market activity. We interviewed some of the key people in the organisation and looked at Board documents and risk registers to understand how resourcing adequacy is being considered. We also considered how policies and procedures captured the activities undertaken.

FMA observations

Catalist's level of resourcing appears adequate for its current scale. During the review it became apparent that there is key person risk with the Chief Executive Officer (CEO). Although this is not uncommon with businesses of this size, it is something that needs to be managed. Catalist and the Board are aware of the risks. Catalist has recently onboarded a new staff member to further reduce the key person risk.

Given that Catalist is in the initial stages of growth, the higher-level policies and procedures are mature in scope. However, Catalist needs to make sure that all day-to-day processes and controls are documented and are continually refreshed as Catalist grows and staffing potentially changes.

Conduct monitoring

Background and review

Conduct is a key aspect of a market operator's role, and Catalist is required to have adequate arrangements for monitoring the conduct of market participants. Under relevant Catalist policies, conduct monitoring is the responsibility of all directors, staff and contractors involved in any market surveillance, investigations, or enforcement action against any Catalist issuer or investor, or who are involved in any trading activity on the Catalist Public Market (including restricted auctions). Currently, the Catalist CEO is responsible for oversight over activities and ensuring they are undertaken in accordance with the policy.

Catalist uses periodic auctions to facilitate trading; this is a key feature that distinguishes it from most traditional stock exchanges, many of which provide a continuously traded market, meaning buyers and sellers can usually trade at any time while the market is open.

Disclosures by issuers listed on the Catalist Public Market are required periodically, instead of on a continuous basis³. Periodic reporting requires disclosure of 'all material information' for each auction period.

We reviewed relevant documents and held discussions with key staff regarding conduct monitoring. We note that there was only one auction held within the review period. Therefore, discussions around this auction centred on how Catalist approached the monitoring and surveillance, and what filters and processes are in place to identify anomalous activity. We also reviewed and discussed the onboarding process for public issuers, and issuers' disclosure obligations.

FMA observations

We observed internal processes are in place to support due diligence for onboarding new issuers. We discussed processes and alerts in place for ongoing conduct monitoring. Given the stage of Catalist's development, we were not able to fully test the processes. However, in the context of activity and issues that arose, we were satisfied that Catalist adequately monitored and managed conduct of its participants during the review period and followed appropriate processes in response to matters arising. We acknowledge that there are several factors that contribute to ongoing conduct monitoring success and are satisfied that Catalist currently has adequate arrangements in place.

Risk management

Background and review

Good risk management practices form an important part of a market operator's ability to demonstrate:

- it has, to the extent that is reasonably practicable, done all things necessary to ensure that its licensed markets are fair, orderly and transparent
- adequacy of its arrangements and sufficiency of resources.

Good risk management also covers how complaints are recorded and dealt with. Catalist's risk management framework encompasses key areas such as incident response, disaster recovery, risk registration with risk tolerance thresholds and mitigation strategies, and compliance assurance planning.

³ Financial Markets Conduct (Catalist Public Market) Regulations 2021 (LI 2021/112) 8 Alternative disclosure provisions apply to Catalist Public Market – New Zealand Legislation

Given the above, we reviewed relevant policies, protocols and controls, risk registers and held discussions with key staff.

FMA observations

The current scale of size and activity means that individuals within the organisation undertake a broad range of activities. At present, the Chief Financial Officer (CFO) and the Head of Compliance (HoC) are combined roles, with many risk management activities performed by the CEO. The HoC's responsibility is to support the Catalist CEO with market surveillance. After reviewing the CFO and HoC job descriptions, and talking with key staff, we would expect in time to see a move towards separation of the CFO and HoC roles, with risk management oversight moving away from the CEO. As Catalist is in its early stages of growth, this was not a major concern. However, we expect Catalist to clearly define and regularly monitor the activities performed by the CEO, CFO and HoC. As activity expands, roles and responsibilities – and separation of these – should be regularly reviewed. Catalist has stated it is committed to the formal, systematic, and structured proactive management of risks across the organisation, which was seen in the policy document we reviewed.

Conflict management

Background and review

Catalist is required to have adequate arrangements for handling conflicts between commercial interests and the need to ensure its licensed market is fair, orderly, and transparent. Conflict management covers conflicts of interest, how they are recorded, and the policies underpinning how they are handled. Conflict management also covers regulatory decisions, how they are made, and how they are escalated. To understand how well Catalist manages conflict management, we reviewed relevant process and policy documents, as well as having discussions with key staff.

FMA observations

We note that during the review period, there was a small number of conflicts recorded on the register. Each matter was appropriately escalated, in line with the policy, and conflicts within Catalist were considered when escalated. We are satisfied that Catalist has adequate measures in place to identify, record and escalate conflicts. As noted in the risk management section, as Catalist grows and matures, we expect to see further segregation of roles to enhance conflict management arrangements.

Arrangements for enforcing compliance

Background and review

Catalist is required to have adequate arrangements for enforcing compliance with market rules. To understand how well Catalist manages enforcement, we reviewed relevant process and policy documents, and had discussions with key staff. We considered Catalist's approach to investigation of potential breaches, and the process Catalist followed.

FMA observations

We note no enforcement action was necessary during the review period, so we have not been able to fully test the effectiveness of the arrangements in place. However, based on the information available, the FMA is satisfied that Catalist has appropriate measures in place to undertake inquiries and enforcement.

Arrangements for notifying disclosures

Background and review

Catalist is responsible for notifying disclosures made to it under a disclosure obligation and for continuing to make those disclosures available. Issuers are required to make all material information available to investors prior to each trading auction, and Catalist has committed to having the relevant technology functionality and processes to make the information available on its platform in a timely manner. For this review we looked at the Catalist website pages relevant to disclosure arrangements. We also reviewed the policies and procedures, talked with key staff, and reviewed the system and how disclosures are made available before and during an auction.

FMA observations

We are satisfied that Catalist has adequate measures in place to make disclosures notified to it available (such as market announcements, substantial product holder (SPH) and other relevant interest disclosures, and alternative disclosures).

Appendix: Our role in reviewing Catalyst

Our role

The FMA is an Independent Crown Entity and one of two main regulators of New Zealand's financial markets. Our purpose is to promote and facilitate the development of fair, efficient and transparent financial markets.

Under the FMC Act, we are required to review, at least annually, how well a licensed market operator is meeting its obligations. We are also required to publish a written report of the review.

If we consider, after carrying out a review, that a licensed market operator has failed or is failing to meet any one or more of its market operator obligations, we may, by written notice, require the licensed market operator to submit an action plan to the FMA.

Market operator obligations

- In the FMC Act, 'market operator obligations' means the general obligations in respect of licensed markets (section 314):
 - to ensure, to the extent that is reasonably practicable, that each of its licensed markets is a fair, orderly and transparent market
 - to have adequate arrangements for notifying disclosures made to it from participants in its markets, and for continuing to make those disclosures available
 - to have adequate arrangements for handling conflicts between its commercial interests and the need to ensure its markets operate in a fair, orderly and transparent manner
 - to have adequate arrangements for monitoring the conduct of participants in its markets
 - to have adequate arrangements for enforcing compliance with market rules
 - to have sufficient resources (including financial, technological, and human resources) to operate its licensed markets properly
- an obligation to respond to a request from the FMA to make changes to market rules (section 333)
- an obligation to give the FMA an annual self-assessment of compliance with its obligations (section 337)
- an obligation to act on the directions of the FMA or the Minister, if the operator is found to be failing to meet any of its obligations (sections 340 to 342)
- any obligation imposed as a condition of a market operator's licence.

Catalist licensed markets

Catalist has a financial product market licence under clause 316 of the Act to operate the Catalist Public Market.

Details of Catalist's licence are on [our website](#).

