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NEW ZEALAND
BusinessROUNDTABLE
PROMOTING POLICIES FOR A BETTER NEW ZEALAND

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Hon Pete Hodgson
Minister of Commerce
Parliament Buildings
WELLINGTON

Proposed Declaration of Unlisted under the Securities Markets Act

This submission is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests. Because of the size of its member companies, few of them have a direct interest in Unlisted. We do, however, have a strong interest in New Zealand's capital markets and regulatory policies affecting them.

We make this submission in response to the then minister of commerce's letter of 15 December 2004 to Unlisted stating that "I intend to declare Unlisted subject to the provisions of the Securities Market Act" 1988 (the Act). Section 36D requires the minister to be satisfied that to fail to impose this requirement would be detrimental to: (1) the integrity or effectiveness of securities markets in New Zealand; or (2) the confidence of investors in securities markets in New Zealand.

In an accompanying letter the minister set out under four headings her reasons for not being satisfied that these conditions were met. These related to: the size and nature of Unlisted; comparative international regulation; regulatory difference and arbitrage; and an alleged potential for confusion.

By way of preliminary comments, we note the following points:

- it was never the intention of legislation governing the New Zealand market for securities trading to shelter the New Zealand Exchange (NZX) from competition;
- choice and competition in securities trading are important advantages for investors and important protections against inefficiency on the part of exchanges;
- the operation of Unlisted is not 'unregulated'. It is subject to many statutory and common law requirements;
- if Unlisted were forced to become a registered exchange with higher costs, many of its issuers would revert to informal methods of trading which were less satisfactory from their point of view, rather than list on the NZX. There is also considerably more risk to shareholders in less formal share transfer practices; and
- legislation in other reputable securities markets, eg the United Kingdom, permits operations such as Unlisted, and some have been set up.

The minister's letter provided no evidence of any problems for Unlisted's clients. The first three of the minister's four concerns are actually causes for satisfaction rather than concern. The

evidence on Unlisted's level of business indicates, if anything, that it meets its clients' requirements (and therefore section 36D requirements) in respect of confidence, effectiveness and integrity. If they were not sufficiently confident about such basic requirements, why would they invest? The fourth concern appears to be entirely hypothetical. Little notice appears to have been taken of the measures Unlisted has put in place to avoid confusion, eg disclaimers and requirements for brokers to obtain signed acknowledgements of its status from clients before executing transactions.

Any notion that investors are not competent to read simple declarations of Unlisted's regulatory status begs the question as to why the law should regard them as competent to make investment decisions in general, whether on Unlisted or on the New Zealand Exchange. New Zealand cannot hope to have efficient capital markets if legislation is based on the assumption that investors cannot read and comprehend simple statements.

On the matter of whether any concerns are real or imaginary, a review of the material supplied by the Ministry of Economic Development in response to an Official Information Act request confirms the Ministry has uncovered no evidence of any problem with investor confidence or with the integrity or effectiveness of securities markets in New Zealand. This is unsurprising since investors are not obliged to invest in companies that use Unlisted's services. We are not aware of any unwarranted barriers to entry facing any enterprise that might want to set up in competition with Unlisted. If Unlisted were failing to provide value for money to its clients, or insufficient choice, others could step in to do a better job.

We would expect a minister to require competent advice from officials on such matters and to avoid restricting the freedom of investors to arrange their own affairs unless it is clearly in the public interest to do so. The burden of proof should be on those advocating such restrictions. After all, investors will not have confidence in the New Zealand market if an intrusive ministerial action is seen to be ill-justified.

In our view, the Ministry of Economic Development should be required to undertake a competent analysis of this regulatory proposal (in the form of a regulatory impact statement) before any further action is considered. A starting point in any regulatory analysis is to establish that perceived problems are real rather than unfounded, and to move from symptoms to underlying causes. At this stage we find no evidence that the ministry has even got to this point. We recently commented about the problem of policy being determined on the basis of hypothetical concerns rather than real problems in our February 2005 submission on the Securities Legislation Bill.[1]

It is well understood in the economic theory of regulation that state regulators and the firms they regulate have a common interest in raising the costs of services provided outside the regulator's purview. Regulatory policy makers are often captured by interested parties. In the current instance, these appear to be government regulators (domestic and international) and the New Zealand Exchange. Regulators naturally wish to expand their powers and to limit the ability of investors to access services that offer greater value for money than the services provided by parties they are regulating. The concerns in the previous minister's letter about Unlisted's greater reliance on private rules for regulation rather than on state regulation appear to fall into the 'regulatory capture' category. It is disappointing that the New Zealand Exchange, which ought to be a voice for competition and enterprise throughout the economy, is apparently lobbying in a self-serving way to limit competition for its services.

[1] http://www.nzbr.org.nz/documents/submissions/submissions-2005/security_0305.pdf

In summary, we strongly urge you to resist the assumption that investors can best be protected by limiting their freedom of action. To the contrary, the burden of proof should be placed on those who propose such limits. In our view the arguments put forward to date do not establish a valid case for registering Unlisted.

We would also urge you to decide the matter on this basis without delay. Unlisted has done nothing wrong – no one is accusing it of unlawful behaviour – and we understand its business has been adversely affected by the minister's intervention.

I would appreciate the opportunity to discuss this submission with you.

Yours sincerely

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