Regulation – Does New Zealand have too much or too little?

Eriksen’s Conference

Wellington 31 May 2011
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“Throughout the stock market boom no one was more vehemently critical of the Australian regulatory system than New Zealand’s high-flying entrepreneurs. They operated within a remarkably lax regulatory regime in which the NZ Securities Commission was frequently frustrated in its attempts to maintain good order. When they crossed that Tasman they encountered firmer restraints and many of them resented the fact and were outspoken in their criticism.

Those who were aware of the excesses practices in New Zealand were not surprised that the crash of October 1987 hit the country particularly hard – far harder than it hit Australia.”

Henry Bosch
Why do we need Regulation?

• To promote confidence in our securities markets
• To ensure these markets are efficient
• To ensure that these markets allocated resources to where they are most efficiently used
Are our securities markets efficient and popular?

Sharemarket capitalisations (Local currencies billions)

<table>
<thead>
<tr>
<th></th>
<th>March 2011</th>
<th>Change</th>
<th>December 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>21,397</td>
<td>+516%</td>
<td>3,476</td>
</tr>
<tr>
<td>Australia</td>
<td>1,448</td>
<td>+341%</td>
<td>328</td>
</tr>
<tr>
<td>Singapore</td>
<td>819</td>
<td>+283%</td>
<td>214</td>
</tr>
<tr>
<td>London</td>
<td>2,669</td>
<td>+208%</td>
<td>867</td>
</tr>
<tr>
<td>New York</td>
<td>18,895</td>
<td>+177%</td>
<td>6,815</td>
</tr>
<tr>
<td>New Zealand</td>
<td>58</td>
<td>+18%</td>
<td>49</td>
</tr>
<tr>
<td>Tokyo</td>
<td>301,251</td>
<td>(18%)</td>
<td>365,716</td>
</tr>
</tbody>
</table>

The total value of the NZX in 1987 was $42.4b. Adjusted for inflation this would now be $78.4b.
Our Sharemarket is tiny

<table>
<thead>
<tr>
<th>Sharemarket</th>
<th>As a % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>803%</td>
</tr>
<tr>
<td>Singapore</td>
<td>270%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>181%</td>
</tr>
<tr>
<td>United States</td>
<td>128%</td>
</tr>
<tr>
<td>Australia</td>
<td>79%</td>
</tr>
<tr>
<td>Japan</td>
<td>65%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>30%</td>
</tr>
</tbody>
</table>
New Zealanders have invested far more in housing

NZ Household assets ($billion)

<table>
<thead>
<tr>
<th></th>
<th>December 2010</th>
<th>Change</th>
<th>December 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential houses</td>
<td>599</td>
<td>+229%</td>
<td>182</td>
</tr>
<tr>
<td>Bank deposits</td>
<td>98</td>
<td>+180%</td>
<td>35</td>
</tr>
<tr>
<td>Other Financial assets</td>
<td>115</td>
<td>+83%</td>
<td>63</td>
</tr>
<tr>
<td>Total Financial assets</td>
<td>213</td>
<td>+117%</td>
<td>98</td>
</tr>
</tbody>
</table>

Source: Reserve Bank

Australia over the same period;
Residential houses +303%
Deposits +249%
Other financial assets +230%

The ratio of residential houses to financial assets is 2.8 in NZ and 1.6 in Australia.
Why have our capital markets failed to grow?

- Industry must take much of the blame, lack of leadership & short sightedness
- A tax regime that favours property, National Superannuation & no compulsory super
- Poor regulation and poor enforcement
The consequence is a low level of investment

Investment as a % of GDP compared with OECD norm

[Graph showing investment as a % of GDP from 1975 to 2007 for different countries including New Zealand, Australia, United States, and OECD.]
Our tradable sector is slumping
A Brief History of Regulation

- No real regulation until Securities Commission was formed in 1978
- Markets were unsophisticated, participants basically honest
- Huge opposition to Commission, market leaders didn’t want regulation
- Commission under funded, confusion whether it was a regulator or should put more emphasis on law reform
- Commission not equipped to deal with Ron Brierley, Bruce Judge and deregulation of financial markets
- Commission had limited resources and powers to curb the 1980s sharemarket boom
- Sharemarket peaked at market cap of $42.4b. It would have to be $78.4b today to be the same in real terms but it is only $58.0b
Post 1987 Crash

- A large number of enquiries, Russell report on the Sharemarket
- Overhaul of NZ Stock Exchange
- But little significant progress
- Business Roundtable played a major role in stopping reform
• Enforcement, not rules are the problems. Countries, such as Luxembourg, which have few rules have strong capital markets.

“We conclude that there are serious deficiencies in the enforcement of our laws. In our view this is a critical shortcoming in our regulatory environment.”

“In Group’s view, the enforcement regime should, in the first instance emphasise private enforcement. The prospect of private recovery of damages for breaches of the law is more likely to maintain the right incentives for good law and good conduct.”
1990s – The lost decade

• Takeover Act, passed in 1993 but Code not implemented until July 2001

• The Lion Nathan/Kirin deal

• Bob Jones and the Securities Commission

• Wilson Neill insider trading case

• Very poor governance and management at NZX
Little progress in the 2000s

- Jane Dyplock appointed Chairman of the Securities Commission in 1991
- Mark Weldon appointed CEO of NZX
- Takeover Panel is very well run
- Prospectus oversight very poor
- Finance company collapses
- Financial advisers debacles
- Residential property becomes more and more popular
Where do we sit now?

• Financial Markets Authority. Will it work?

• Finance companies come under the wing of the Reserve Bank. Too late?

• Authorised Financial Advisors. Too many exemptions, rules are petty.

• Securities industry participants not keen to make improvements. Want to protect their special interests.

• NZX not a good regulator.
Regulation – Does New Zealand have too much or too little?

• New Zealand has poor regulation

• New Zealand has poor enforcement

• We don’t need more regulation, we need better regulation

• We then need this regulation to be enforced

• The Takeovers Code is a good example of good regulation, well communicated and enforced

Thank You