



JUNE 2021

Market Operator Obligations Review – NZX

Findings from the FMA's review of how well NZX is meeting its
licensed market operator obligations, for the period
1 January to 31 December 2020

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Executive summary

About this report

The Financial Markets Conduct Act 2013 (FMC Act) requires the FMA to carry out a review and report on how well NZX is meeting its licensed market operator obligations. One of the key objectives of these annual reviews is to act as a mechanism to ensure that potential conflicts between regulatory and commercial functions of NZX, as a self-regulating organisation (SRO), are appropriately managed. The FMA may carry out this review at any time but must do so at least once a year.

This is the second report in relation to the review of NZX for the period from 1 January to 31 December 2020 (“the review period”). The FMA previously performed a targeted review of NZX, focused on the sufficiency of technological resources and their impact on NZX’s ability to meet any of its other general obligations. The outcome of the targeted review was published in January 2021 and is available on the [FMA website here](#).

This report, while providing an update on the outcomes and actions arising from the targeted review, focuses on the work we have carried out to assess other aspects of NZX’s compliance with its licensed market obligations during the review period.

How we approached this review

We carried out a comprehensive review, considering that for the prior review period we employed a more tailored approach in response to the COVID-19 national lockdown and significant market volatility. The scope of this review was also influenced by:

- NZX’s implementation of a new regulatory model
- changes made to NZX’s surveillance system
- areas noted in our previous review for the year ended 31 December 2019 (“[June 2020 report](#)”)
- on-going monitoring and feedback we have provided to NZX
- the work already performed as part of the targeted review and subsequent communications with NZX.

We employ a risk-based approach to monitoring, and while this review is of NZX’s overall compliance with its licensed market operator obligations, we have exercised judgement in selecting areas of focus, and the level and detail of work performed in each. This report highlights our main findings and observations from the review, and as with any risk-based approach has inherent limitations.

The review involved a significant amount of information and interaction with NZX. We reviewed selected policies and procedures, samples of enquiry files, policy work, alert assessments and training materials. We also conducted an on-site walk-through of the surveillance alert analysis and management.

During the review period, NZX implemented a new regulatory model with the creation of a subsidiary, NZX Regulation Limited (NZ RegCo), to perform all frontline regulatory activity. This activity includes market surveillance, issuer and participant compliance, and oversight of arrangements for managing conflicts. In performing this review, we met with members of NZX’s policy, operations and technology teams as well as

representatives of NZ RegCo and its board, and the NZ Markets Disciplinary Tribunal (NZMDT) and its Special Division.

While we met with the Chief Information Officer of NZX, we did not carry out further testing on the technology resourcing at this time given that, separately, we recently approved NZX's action plan provided by NZX in response to our targeted review. This action plan is extensive and in carrying out the review and making recommendations, we were mindful of the actions which the NZX have already committed to. We will be monitoring NZX's implementation of this action plan throughout the next review period. More details on this are available in '[Technology and the targeted review](#)'.

In summary, we focused our review on the following areas:

- surveillance monitoring
- aspects of conflicts management
- monitoring and enforcement in relation to continuous disclosure requirements.

More information on the approach to each focus area is set out within the applicable sections.

Highlights

We have made several observations during the review, relevant to our overall assessment as to whether NZX met its general obligations in the review period. In some instances, we have made recommendations for improvements to certain processes or controls. In producing these recommendations, we have applied a rating scale to indicate the varying degrees of importance. This is designed to assist our overall assessment of compliance within each area, as well as to indicate the relative priority of our recommendations. More information on the rating scale can be found in Appendix 2.

Findings

Our key findings are as follows:

- NZ RegCo's surveillance function (NZRS):
 - responded well to COVID 19 uncertainties in managing the changes to working environments created by lockdowns without any apparent impact on the effectiveness of its monitoring function, and prioritising real-time monitoring given the increased market volatility and turnover following market sell off in Q1 of 2020.
 - enhanced its monitoring tools through upgrades to its market-monitoring software (SMARTS) alerts, and development of additional in-house tools.
- We found the overall design of NZ RegCo to be well planned and initial implementation well executed, with the NZ RegCo team set up to operate with a high level of independence from NZX.
- With respect to policy matters, overall, we found that there is a good level of collaboration between NZX and NZ RegCo and regulatory considerations are often a driver behind the policy changes. We identified some enhancements, which are set out in the Recommendations section below.

- Regarding new listings, we consider the governance controls in the listing approval process with NZ RegCo provide for good conflict management between NZX and NZ RegCo and ensure regulatory decisions about new listings are made without commercial influence.
- The more recent cases and new resources developed by NZ RegCo give us comfort that NZ RegCo implemented processes to ensure more comprehensive continuous disclosure investigations.
- The NZMDT and its Special Division act with a high-level of independence and undertake thorough reviews of referrals received. We identified a further enhancement with respect to the documentation of its monitoring and activities framework, which is set out in the Recommendation section below.

Recommendations

We have made the following recommendations:

Area	Recommendation	Rating
NZX and NZ RegCo: protocols	NZX and NZ RegCo engagement policies should be updated to include protocols on how to resolve differences of opinion, should they arise, between NZX and NZ RegCo.	Medium
NZX: policy decision-making	NZX should develop protocols for policy work to include prioritisation between commercially driven change and regulatory driven change.	Medium
NZ RegCo: continuous disclosure processes	NZ RegCo should continue to focus on improving capability with regards to monitoring and assessing issuer compliance with financial reporting obligations and utilise financial reporting experts when performing such surveillance to ensure reviews are as in-depth as necessary.	Medium
NZX: policy decision-making	NZX should prescribe requirements for a foundation document explaining the case for establishment of a new policy, or policy change.	Low
NZX: policy decision-making	NZX should ensure that documentation to record new policies, or policy changes, that include a high-level of technical judgement on thresholds includes how such thresholds were determined and what level of consultations took place.	Low
Special Division: monitoring framework	Special Division should formalise a monitoring framework to capture how the division performs its activities and monitoring.	Low

Overall assessment

Other than with respect to the findings published in our January 2021 targeted review report, which concluded that NZX failed to meet its market operator obligations by not having sufficient technological resources, we consider that NZX complied with its licensed market operator obligations during the review period by:

- ensuring, wherever reasonably practical, that its licensed markets operated in a fair, orderly and transparent way (“FOT obligation”).
- having adequate arrangements to notify disclosures made to it under a disclosure obligation, and for continuing to make these disclosures available.
- having adequate arrangements for handling conflicts between its commercial interests and the need to ensure its markets are fair, orderly and transparent.
- having adequate arrangements for monitoring the conduct of participants on, or in relation to the markets (“Monitoring obligation”).
- having adequate arrangements to enforce compliance with market rules.
- having sufficient resources (including financial, technological and human resources) to properly operate its licensed markets.

Focus areas

Focus area: Market surveillance

NZ RegCo's market surveillance team (NZRS) performs the frontline oversight of trading on NZX's markets through real-time and post-trade monitoring. NZRS must have adequate processes and systems for monitoring the conduct of participants in NZX's markets, and sufficient and appropriately skilled staff to ensure that market surveillance is operating effectively. The proper functioning of this team is essential to maintaining market integrity, and consequently one of the core functions we routinely test.

In our June 2020 report, we highlighted that on-site testing of NZRS' SMARTS would be an area of focus in this review considering the high volume of surveillance system alerts. Additionally, this year we wanted to test the effectiveness of the function given the changes NZRS made to SMARTS parameters in mid-2020, the high volume of alerts triggered in the first part of 2020, and emerging market trends (in particular, increased retail participation).

Overall assessment

We consider that during the review period NZRS had adequate arrangements across its processes and systems for monitoring the conduct of participants in NZX's markets. It also has sufficient and appropriately skilled staff to ensure that market surveillance operates effectively.

Our review

We focused our review on changes to the surveillance system, the appropriateness and effectiveness of alert management, and overall performance of the surveillance function. As part of our review, we reviewed processes for assessing and investigating potential misconduct cases, methods of surveillance, and all alerts within three sample dates. We discussed the triggers and operation of alerts and had the surveillance team walk us through selected alerts and their approach to analysing those alerts. We also considered how market developments influenced the team's approach to surveillance, the team's experience and capacity for managing monitoring activities, and the team's working relationships with other NZ RegCo teams as well as wider NZX teams.

Observations

In this review period, NZRS:

- handled a large number of SMARTS alerts arising from increased volatility and turnover during the year. During the months of May and June 2020, NZRS directed its efforts and resources to real-time alerts monitoring with this function occupying ~77% of the team's resources at the peak of COVID-19 induced market volatility. This compares with ~25% of analyst capacity historically.

- referred an increased number of potential misconduct cases to the FMA, the participant compliance team and to Special Division.
- completed a review and upgrade of the SMARTS surveillance infrastructure to improve effectiveness of its monitoring function, reduce the number of 'false positive' alerts and future proof the system for expected market developments.
- implemented a new in-house tool to prioritise accounts of interest in insider trading investigations.
- together with participant compliance, engaged with market participants on their practices and potential improvements.

Findings

NZRS has responded well to COVID-19 uncertainties in terms of:

- managing the changing work environment created by lockdowns without any apparent impact on the effectiveness of its monitoring function.
- effectively managing the increased workload in terms of both real-time monitoring as well as potential misconduct assessments with its existing resources.

From our testing of SMARTS alerts and our engagement with NZRS, we are satisfied that the team has a good understanding of the markets and is sufficiently skilled to perform the market monitoring function effectively and efficiently.

NZRS is active in making enhancements to its monitoring tools, and there has been continued improvement in the quality of NZRS' assessments and the evidentiary information captured in its referrals to the FMA.

Next steps

The number of SMARTS alerts has significantly reduced following NZRS' upgrade project in 2020. NZRS is confident that, despite this reduction, the new alerts package has improved its ability to detect market misconduct and other anomalous trading. The effectiveness of the new SMARTS alerts and parameter recalibrations will continue to be an area of interest for FMA in 2021. Additionally, we will focus on how the team deals with market changes, developments and trends.

Focus area: Conflicts management

NZX is required to have adequate arrangements in place to manage any actual or perceived conflicts of interest between its regulatory responsibilities and its commercial interests. Appropriate conflict management arrangements are especially important for maintaining market confidence in NZX as a self-regulatory organisation.

As indicated in our June 2020 report, this has been an area of continued focus for the FMA, particularly the relationship between the commercial and regulatory functions and how this may impact policy decision-making.

In this review period, NZX:

- implemented a new regulatory model, with the structural separation of its regulatory and commercial functions.
- disestablished both the Regulatory Governance Committee and Conflicts Committee, with NZ RegCo taking over certain conflict management responsibilities.
- obtained a further external review of the adequacy of its conflict management arrangements.
- made changes to the Listing Rules to facilitate direct listings¹ and updated the associated guidance and practice note.

Overall assessment

We are satisfied that NZX met its obligations to have adequate arrangements in place to manage conflicts. We have made some recommendations for improvement to policy decision-making and implementation protocols to further enhance aspects of conflict management in this area.

Our review

Conflict management is a broad and complex area, accordingly we have set out below our approach and conclusions reached in assessing each of the following focus areas:

- the design and initial implementation of the new model, including any impact it had on specific focus areas.
- policy decision-making, and the tension between commercial and regulatory policy decisions.
- review and approval (or decline) of new listings.

NZ RegCo design

Our review

We reviewed establishment documents and charters, protocols for interaction between commercial and regulatory teams, delegated authorities, minutes of meetings and risk management frameworks.

We also made enquiries relating to the implementation of NZ RegCo to assess the design of the new model and how NZ RegCo will work and interact with NZX's commercial entities and teams. While we discussed certain aspects relating to execution, and how the model has been operating, given that implementation only occurred at the end of this review period, we have not assessed operating effectiveness. This will be a focus area in our next review.

In considering the new model and NZ RegCo interactions, we also reviewed and made enquiries regarding:

- the design and involvement of the NZ RegCo Board.

¹ A direct listing is when the company lists without raising new capital from retail investors. It can be a new listing of a private company's shares (a compliance listing) or a reverse or backdoor listing into an existing listed entity.

- interactions with NZX, the NZ Markets Disciplinary Tribunal and its Special Division.

Findings

We found the overall design of NZ RegCo to be well planned and initial implementation well executed, with the NZ RegCo team set up to operate with a high level of independence from NZX. The new model provides for more robust conflict management arrangements, and more focused governance and strategic support for the regulatory function.

In reviewing applicable protocols, we identified an area for improvement in that there are no protocols for dealing with resolution of any differences of opinion. NZX Board and NZ RegCo Board have put in place delegations in relation to policy matters. The NZX Board must not approve new rules, amendments to market rules, or material changes to enforcement and regulatory policies without prior engagement with NZ RegCo.

A framework further sets out the relationship between NZX Policy and NZ RegCo, and the interactions between the teams, and is designed to ensure no undue influence of commercial activity over policy decision-making. The policies and procedures do not confirm exactly what "prior engagement" means. While it is clear the NZX Policy and NZ RegCo teams must collaborate, it is unclear what protocols both NZX and NZ RegCo should follow in the event of any dispute, or difference in opinion, regarding policy changes.

Policy development and implementation

Our review

To test policy development and implementation more closely, we reviewed documents and procedures in relation to policy development, relationship charters and protocols for interaction between commercial and regulatory teams, and minutes of meetings. We reviewed a specific policy NZX introduced during the review period including its design, the consultations process undertaken, and consideration of submissions received in response. Additionally, we interviewed personnel from NZX Policy and NZ RegCo to better understand processes.

Findings

Generally, we found that there is a good level of collaboration between NZX and NZ RegCo. Regulatory considerations are often a driver behind the policy changes, and our review did not indicate a lack of regulatory considerations in the policy decision making process.

In reviewing policies and protocols, we identified the following areas for improvement:

- **Policy establishment protocols**

We found that there are no prescribed requirements for a foundation document regarding a new policy, or policy change, confirming the reasons for such a policy to be drafted. Such protocols should be in place, and also include the levels of review or input that are required, and by which teams, to ensure

appropriate personnel are included within the policy setting process, and at the appropriate times, and whether the proposed policy involves a rule change or is intended as guidance.

- **Protocols for policy setting matters requiring high-level of technical judgement**

We found that where new policies, or policies changes, include a high-level of technical judgement and decision-making (in setting parameters or thresholds for example), the processes in place are not sufficiently robust to ensure sufficient documentation is retained to support how those thresholds were determined, and what level of consultation took place in deciding why such a threshold was appropriate.

- **Policy setting prioritisation**

As noted above, there are clear protocols in place for collaboration between NZX Policy and NZ RegCo in terms of policy setting processes. Often policy changes will be driven from NZ RegCo, as part of a need for regulatory change. At present, the policies and procedures do not determine how the policy team should prioritise between commercially driven change and regulatory driven change. We have previously raised concerns with NZX about the potential conflicts that may arise by virtue of its policy decision-making sitting within, and being driven by, its commercial function. We want to ensure that the regulatory impacts are given sufficient consideration and are appropriately prioritised.

New listings

Our review

New listings are a key point of potential conflict of interest between NZX and NZ RegCo as NZX has a strong incentive to have new companies list on its markets. It is important that the drive to grow the number of listed companies on NZX's markets does not influence an objective assessment of whether an applicant is suitable for listing. NZ RegCo has responsibility for ensuring that companies seeking to list can demonstrate they can meet the regulatory obligations and standards expected of a listed company.

We considered the impact of NZX's structural changes on the approval of new listings and reviewed NZ RegCo's processes, templates and other related protocols for assessing and approving listing applications. We also discussed these processes with NZ RegCo personnel. During the year, as part of our quarterly file reviews, we also looked at the assessment of reverse listing applications.

Findings

We consider the various governance controls in the listing approval process with NZ RegCo provide for good conflict management protocols between NZX and NZ RegCo to ensure regulatory decisions regarding new listings are made without commercial influence.

Under the new structure, both NZX and NZ RegCo CEO's must jointly approve a listing. NZ RegCo has primary responsibility for assessing applications for listing, assisted by the Listing Sub-Committee (**LSC**) of NZX. NZ RegCo must take into account LSC comments in its decision making.

The NZ RegCo Board must approve a decision to decline or approve a listing “*in respect of which the [LSC] has raised significant concerns or noted the issuer or product presenting a potential conflict or risk for NZX and/or NZ RegCo*”.

NZ RegCo’s processes and procedures for assessing listing applications appear robust, designed to aid consistency and ensure relevant matters are considered for all applications. NZ RegCo has a manual, and templates, to guide staff through the process of assessing a listing application. The manual requires staff to record their assessment and decision-making throughout the process, including “*details of contentious points and why certain decisions were made during the review*”.

Focus area: Continuous disclosure

As noted in our June 2020 report, continuous disclosure is a key mechanism for facilitating the confident and informed participation in financial markets. Providing the market with material information in a timely way is a key component of transparent markets. Effective identification and enforcement of continuous disclosure breaches is therefore an ongoing area of high interest and we continued to assess NZX’s performance in this area during the review period.

In NZ RegCo’s Oversight and Engagement Report for 2020, it was noted that continuous disclosure also remains a priority. As continuous disclosure liability is contained in the FMC Act as well as the Listing Rules, this is also an area where good liaison and collaboration between NZ RegCo and the FMA is essential.

Overall assessment

Earlier in the year, we provided feedback to NZX setting out our concerns in relation to the depth of continuous disclosure related enquiries and analysis. The more recent cases and new resources developed by NZ RegCo give us comfort that NZ RegCo implemented processes to address the issues we raised.

Our review

We reviewed procedures applicable to continuous disclosure monitoring and investigations, guidance initiatives during the year, reports published by NZ RegCo, tools available to staff, training provided and, as part of our on-going monitoring, a sample of files. We also met relevant members of NZ RegCo.

Observations

Regarding guidance initiatives:

- The COVID-19 pandemic meant volatile market conditions and a rapidly changing environment for issuers, particularly in the first quarter of the year as lockdowns and border restrictions were imposed. NZ RegCo was proactive in responding to implications for issuers, providing extra guidance in its April 2020 Issuer Update about continuous disclosure obligations in the context of the prevailing market conditions.

- This included guidance on assessing materiality, and when information may or may not be 'generally available to the market' for individual issuers. It also drew attention to considerations in respect of deviations from financial projections or market expectations, and other possible developments that might arise for issuers and require disclosure, such as cancelling or deferring dividends and raising capital.
- Later in the review period, NZX updated its guidance note on continuous disclosure, expanding advice on how issuers should manage disclosure obligations when performance deviates from market expectations.

Regarding monitoring and enforcement of continuous disclosure matters:

- In its Oversight and Engagement Report for 2020, NZ RegCo noted that while the number of continuous disclosure investigations reduced from 34 in 2019 to 17 in 2020, the complexity of cases continues to increase.
- Our review of continuous disclosure investigation files in the first half of the review period raised concern that the depth of enquiry carried out, and the level of independent analysis and verification of information, was not always sufficient. We also found inconsistency in how staff recorded their assessment of the regulatory components involved in a potential disclosure breach. This made it difficult at times to identify the information that was relevant to the overall findings, and therefore to understand the regulatory decision. This was touched on in our 2020 report and detailed observations were made to NZX in August 2020.
- Following the FMA's feedback, NZ RegCo carried out a review of its continuous disclosure investigation procedures and developed a set of resources for assessing and recording potential breaches of the continuous disclosure rules.
- These resources include a comprehensive guide for staff on how to approach a continuous disclosure investigation as well as templates for recording investigations and decisions, supported by training initiatives. These new resources have been in use since early 2021. We found that the files reviewed in the latter part of the review period were of higher quality in relation to the depth of enquiry and analysis.
- NZ RegCo has also been considering and implementing enhancements to its capabilities for reviewing issuer's compliance with financial reporting obligations. This has included in-house training as well as setting up access to external expertise as and when the team require.

Findings

We consider the changes NZ RegCo has made should help to ensure more comprehensive continuous disclosure investigations, with appropriate consideration of all relevant information, and well-documented and consistent decision-making.

The new resources developed by NZ RegCo seek to address the concerns we raised. The staff manual gives clear guidance on the elements of continuous disclosure and the various considerations that need to be made when assessing potential breaches. It also emphasises the importance of independent analysis of information and applying an appropriate level of scepticism. The templates require staff to record their findings and rationale for decisions in a consistent way, helping to ensure all relevant considerations are made in every case and the reasoning is documented and clear.

We are also satisfied that NZ RegCo managers, including the NZ RegCo CEO, are appropriately involved throughout the course of these cases and at decision making stages, given the importance of effective monitoring and enforcement of continuous disclosure requirements.

We encourage NZ RegCo to continue to focus on financial reporting capabilities to ensure it can monitor issuer compliance, and undertake enquiries, in a robust and effective manner. We recommend NZ RegCo utilises financial reporting experts when performing surveillance of issuer's financial reporting information to ensure reviews are as in-depth as necessary.

Next steps

We will continue to monitor this area through our periodic file reviews and look forward to seeing changes as the resources are implemented in the current review period. The FMA and NZ RegCo also intend to review arrangements and protocols for engagement and interaction, in particular regarding continuous disclosure matters.

Technology and the targeted review

NZX must have sufficient technological resources across its people, processes and platforms to operate its markets effectively. This includes ensuring the availability, security, capacity and maintenance of NZX's trading platforms, settlement systems, internal market monitoring systems and other systems. Failure of market infrastructure can have a significant impact on the confidence in, and the integrity of the market, even where the number of incidents is low. It may also impact NZX's ability to meet its other obligations.

In assessing NZX's performance against its market operator obligations, we are mindful of the critical role NZX plays in the New Zealand economy, and the scale and the reputation of New Zealand's capital and financial markets.

Overall assessment from our targeted review

Our [targeted review](#) found NZX did not have adequate technology capability across its people, processes and platforms to comply with market operator obligations and especially in the context of NZX's systemic importance.

We assessed that NZX failed to meet its market operator obligations by not having sufficient technological resources and that consequently, for some periods this also meant that NZX:

- was not doing, to the extent reasonably practicable, all things necessary to ensure a fair, orderly and transparent market.
- did not have adequate arrangements for notifying disclosures made to it from Listed Issuers, and for continuing to make those disclosures available.

We considered that:

- fundamental tools and practices were either lacking, insufficiently robust or not fully utilised, which impacted NZX's ability to ensure a high quality of system health and resilience in the respects identified.
- crisis management planning and procedures were basic and did not address known points that could cause disruption in the event of failure.
- cultural issues contributed to NZX's failure to meet its general obligations in this regard.

Activities post targeted review

NZX was required to develop a formal action plan to address the issues raised by the FMA. Following the publication of the targeted review, NZX provided proposals to address the issues, and we met with representatives of the NZX Board and NZX management to discuss and agree a suitable action plan and overall responsibility for the action plan's deliverables.

On 6 May 2021, we approved the action plan submitted by NZX covering a range of areas including the governance oversight, resourcing, industry engagements, IT capability, security, crisis management planning, and broader risk management. The action plan is extensive. The NZX Board has the overall

responsibility for the delivery on this action plan and representatives of the Board have reiterated to the FMA the NZX's commitment to delivering on the actions.

We are aware that NZX has already commenced implementation against the actions noted, and in response to the market disruptions last year and the concerns raised by the targeted review, including:

- appointing a new Chief Information Officer.
- establishing a formal technology committee and appointing a member with specialist knowledge.
- launching of a formal project to ensure it delivers on the actions.
- increasing systems' capacity (with further actions pending for capacity planning and monitoring).
- meeting with the representatives of market participants.
- recruitment for additional IT roles.

With the action plan only recently being approved, it is premature to provide more detailed commentary on NZX's progress and our assessment of the quality of output. Recent actions by NZX have addressed some of the short-term suboptimal IT standards and the further actions committed to by NZX will be important to demonstrate longer-term sustainability. NZX's initial report to the FMA reflects that implementation of the plan is on schedule.

Next steps

We will be monitoring NZX's implementation of the action plan throughout the next review period. Our monitoring will include:

- review of progress reports provided by NZX.
- sample testing of completed actions.
- meetings and discussions with relevant NZX representatives.

We anticipate providing a further update on the progress of the action plan as part of the next general obligations review to be published in June 2022, or earlier if appropriate.

Other areas

NZMDT and its Special Division

The NZ Markets Disciplinary Tribunal (NZMDT) is an independent regulatory body established by NZX to determine whether an issuer or market participant has breached NZX's market rules in any matter referred to it by NZ RegCo. The NZMDT's Special Division determines whether such rules have been breached by NZX and its related listed entities, in ensuring the market rules are applied to NZX in an impartial and independent manner.

Our review

We reviewed documentation provided by the NZMDT, including its rules, referral protocols and various logs and reports on activity undertaken. We selected and reviewed a sample of referrals made by NZ RegCo to the Special Division, and interviewed the Chair of both the NZMDT and Special Division on:

- governance, including interactions with NZ RegCo and NZX.
- composition of the NZMDT and succession planning.
- activity during the period, and processes for reviewing and investigating potential breaches.

Observations

For the review period, we observed that the Special Division received an increased number of referrals from NZ RegCo during the review period.

The level of information provided by NZ RegCo to Special Division in these referrals was fulsome.

Findings

The NZMDT and its Special Division act with a high-level of independence and undertake thorough reviews of referrals received.

We found that the Special Division does not have a formalised framework setting out how it undertakes the activities in order to carry out all its responsibilities. We found that while individual members undertake specific activities, successfully spanning the remit of the Special Division, this was not well articulated or demonstrated within supporting documents as a structured framework.

We note that potential conflicts can arise due to the membership composition of NZMDT (including that of Special Division) and market activity. NZX appoints members of the NZMDT, and while there is no requirement for NZX to consult with the NZMDT with regards to appointments, NZMDT does consider succession planning matters, including for the Special Division, and raises them with NZ RegCo as appropriate.

We recommend continued focus is given to these matters, by NZX, NZ RegCo and the Special Division, to ensure that the succession planning of NZMDT and potential conflicts of interest continue to be effectively managed.

Engagement between product operations and NZ RegCo

Issuers are required to provide all market disclosures to NZX via its Market Announcement Platform (MAP), and to enter certain data directly into MAP in respect of particular announcements (for example a change of director, earnings data or redemptions).

The Product Operations team is responsible for checking that issuers enter data into MAP as required, provide all required information on the relevant prescribed forms and that required data point entries match the content of the corresponding issuer announcement. The team can engage directly with issuers for breaches of Listing Rules regarding data entry issues, as these represent technical breaches of the Listing Rules considered to be minor, quick to correct, and unlikely to ever result in enforcement action beyond best practice discussions with the issuer.

Given the Product Operations team's responsibility to check data provided by issuers, they may become aware of incorrect information, or changes to previously published information, that could have a market impact. An isolated error occurred during the review period when an issuer entered incorrect data for a particular data point. The error in this instance had a market impact, but there was a time lag in Issuer Compliance being made aware of the issue.

Our review

We reviewed a number of process documents and made enquiries of the Product Operations and Issuer Compliance personnel regarding the product operations' role in monitoring market announcements, and how the teams interact to ensure appropriate and timely sharing and escalation of relevant information.

Findings

Overall, the Product Operations team has a good track record of reviewing the circumstances of any errors and taking action to mitigate recurrence.

Following the above noted incident, additional checks were added when verifying data, and the team now receives system alerts when particular data points deviate from previous entries by more than a certain amount. Our conversations with staff indicate that the team has learned from the above incident.

We are satisfied that the nature and frequency of the Product Operations and Issuer Compliance team engagements mean Issuer Compliance should be aware of relevant matters as they arise. The teams may wish to consider whether there are specific data entry events which should require notification from Product Operations to Issuer Compliance, for example changes to particular data points, or movements outside set parameters.

We note that the Product Operations team, which is part of NZX Limited, is undertaking a regulatory responsibility when addressing rule breaches directly with issuers. However, we are satisfied that the arrangements in place are sufficient to address any conflict of interest. Product Operations is a process-driven function with a narrow and fully documented scope of authority.

The breaches they can address are absolute, and there is no discretion to decide whether or not a breach occurred. The breaches are recorded and after a third instance the issuer is referred to Issuer Compliance, who will then contact the issuer. Training on MAP is offered after the first and second instance and is mandatory after a third.

Appendix 1: Our role to review NZX

Our role

We are 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 the FMA considers, 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, it 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 under a disclosure obligation, 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.

NZX licensed markets

NZX is licensed to operate the following markets in New Zealand:

- NZX Main Board
- NZX Debt Market
- Fonterra Shareholders' Market
- NZX Derivatives Market

Details of NZX's licences are on [our website](#).

Our oversight of NZX

The Memorandum of Understanding between the FMA and NZX, signed in January 2015, sets out the principles for our engagement and co-operation, and provides for regular operational meetings. This allows NZX to continually update FMA about its key initiatives and developments throughout review periods. There is also an agreed set of protocols for communications regarding normal business activities concerning both parties.

Our ongoing oversight of NZX in this review period included:

- operational meetings
- quarterly reviews of NZX documentation
- discussions about market matters arising as required
- consulting on NZX policies and proposed rule changes where appropriate
- providing feedback on NZX referrals made to the FMA under the FMC Act.

For purposes of this review, we also reviewed and considered documents and information provided to us including:

- corporate structure and governance arrangements
- minutes of the select Board and committee meetings
- protocols and engagements between NZX, NZ RegCo, NZMDT and Special Division
- risk management framework
- NZX's 'Market Assessment Report' setting out self-assessment of its compliance with market operator obligations
- NZX's 'Oversight and Engagement Report'
- the NZMDT's Annual Report 2020
- project documents
- policies and procedures
- issuer engagement and training materials

Appendix 2: Ratings explained

The following rating scale has been used to demonstrate the significance of our recommendations:

Rating	Definition
Low	Minor process or control issue identified, but is unlikely to have had a material impact on the overall effectiveness of the systems and the entity's ability to comply with its obligations.
Medium	Process or control issue, with the potential to have a moderate impact on the overall effectiveness of the systems and the entity's ability to comply with its obligations.
High	Process or control issue requiring immediate attention that did, or may have, a significant effect on the overall effectiveness of the systems and the entity's ability to comply with its obligations, given its significance or systemic nature.

Action plans to implement changes should be prioritised by the rating of each recommendation with remediation of high-level findings requiring more immediate priority.

Glossary

Term	Definition
Issuer or Listed Issuer	Any company that is or has been listed on any of NZX's markets
Licensed markets or NZX's markets	The financial product markets NZX is licensed to operate under the FMC Act
Listing Rules	NZX rules governing Issuers on NZX's licensed markets
Market operator obligations	Obligations imposed on a licensed market operator as a condition of its licence or under sections 314, 333, 337, 340, 341 and 342 of the FMC Act
Market rules	All of the rules governing NZX's licensed markets, including Listing Rules, participant rules and NZMDT rules
Participant or market participant	A participant in the licensed markets who has been accredited and approved by NZX under the participant rules
Participant compliance	Team within NZ RegCo responsible for accreditation and monitoring of Participants' compliance with Participant rules
Participant rules	NZX rules governing participant firms

