

OVERSIGHT REVIEW OF NZX

1 January 2009 – 30 June 2010

SECURITIES COMMISSION

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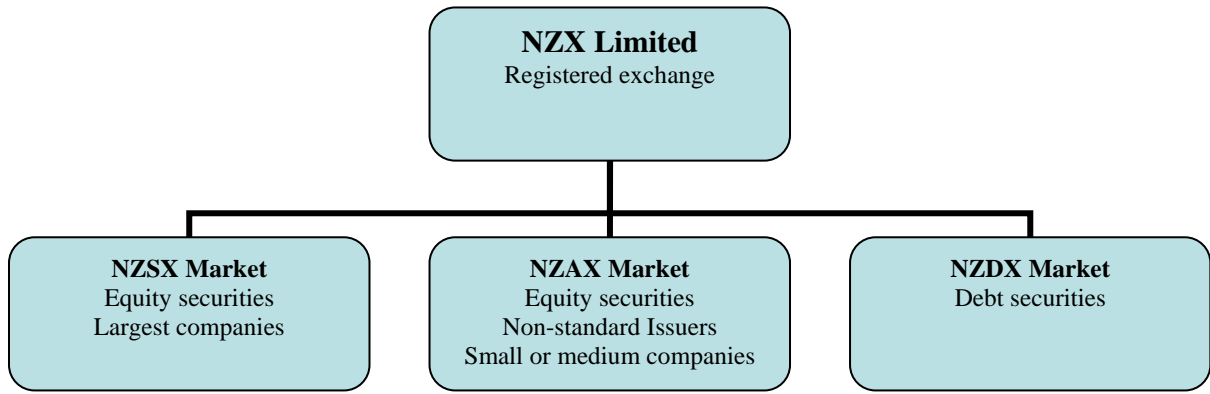
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STRUCTURE OF NZX AND ITS SECURITIES MARKETS



EXECUTIVE SUMMARY

1. The Securities Commission has reviewed NZX's performance of its regulatory functions as a registered exchange under the Securities Markets Act 1988. This review, the fifth oversight review of NZX to be conducted by the Commission, focussed on NZX's arrangements for discharging its obligations (as specified in paragraph 12) during the period from 1 January 2009 to 30 June 2010 and developments, relating to matters within the scope of the review, up to the date of this report.
2. Future oversight reviews of NZX's regulatory performance will be undertaken by the Commission's successor body, the FMA, pursuant to the Securities Markets Amendment Act 2011 which will come into force on 1 May 2011.
3. We report on NZX's regulatory performance in regard to the following:
 - supervision of Market Participants and enforcement of the Participant Rules;
 - supervision of Issuers and enforcement of the Listing Rules;
 - allocation of human, technological and financial resources as it affects performance of the regulatory functions of NZX;
 - internal practices and procedures associated with investigations, price enquiries, complaints-handling and referrals;
 - discipline practices, procedures and resources;
 - arrangements for market infrastructure development and maintenance;
 - Special Division practices, procedures and resources;
 - corporate governance arrangements, including board composition, policy setting, crisis response and oversight of executive management, with reference to regulatory standards relating to governance of demutualised exchanges under IOSCO and other international principles; and
 - the impact, if any, of NZX's expanding commercial activities on its regulatory function.
4. The Commission's overall conclusion is that NZX is satisfying its obligations to operate its markets in accordance with its Conduct Rules.
5. The Commission findings are set out below.

Matters arising from the 2008 oversight review

6. The Commission is satisfied that NZX has either resolved or responded appropriately to matters arising from the review of the 2008 year (see paragraph 17).

Matters arising from the Review Period

7. The Commission's overall conclusion is that NZX is satisfying its obligation to operate its markets in accordance with its Conduct Rules.
8. The Commission makes the following general recommendations:
 - That NZX ensures that adequate resources are maintained at all times to enable essential supervisory functions, such as onsite inspections, to be carried out despite other competing matters requiring the attention of the Market Supervision Group of NZX.
 - As it is intrinsic in the current structure of NZX that a conflict of interest could arise between the commercial and regulatory functions of NZX, the Commission recommends that this structure and its outcomes remain under review in further oversight reviews and that NZX in particular consider whether a sole delegation to the Head of Market Supervision is a more appropriate structure for the management of perceived and/or actual conflicts of interest between the commercial and regulatory functions of NZX.
9. The Commission recommends that NZX undertake the following specific actions:
 - *NZX carries out scheduled onsite inspections in accordance with its methodology. The Commission notes that NZX is already underway with this.*
 - *NZX to implement a means of recording actual human and other resources devoted to market supervision in order to increase transparency of resourcing.*
 - *NZX to complete its review of any changes to be made to the Participant Rules and its communications as a result of the dispute resolution provisions contained in the Financial Service Providers (Registration and Dispute Resolutions) Act 2008 for consideration during 2011.*

INTRODUCTION

10. This is the Commission's fifth oversight review of NZX's performance of its regulatory functions as a registered exchange under the Securities Markets Act 1988. It covers the period from 1 January 2009 to 30 June 2010 and general developments, within the scope of the review, since the end of the Review Period. Future oversight reviews will be carried out by the Commission's successor, the FMA (see paragraphs 115 to 118).
11. This review considered NZX's performance in discharging its regulatory functions by reference to the matters set out in paragraph 3.
12. NZX is obliged, as a registered exchange under section 36G of the Securities Markets Act 1988, to operate each of its markets in accordance with its Listing Rules and Participant Rules.
13. The Commission has statutory functions to review practices relating to securities and activities on securities markets, and to comment on them. This requires the Commission to keep under review and comment on NZX's performance of its obligations as a registered exchange.
14. NZX was asked to provide the Commission with a self-assessment report in relation to its performance over the Review Period. This formed the basis of the review. The Commission undertook further examination of particular areas seeking additional information from NZX, interviewing Board members, senior NZX staff members and the Chairmen of each of the NZMDT and the Special Division and reviewing files of NZX. Further information in relation to the methodology is provided in Appendix 3.
15. Defined terms, the background to the review and the process that was followed, are set out in the Appendices to this report.
16. Findings and observations are divided into the following sections:
 - Matters arising from the review of the 2008 year
 - Market conditions and NZX activities over the Review Period
 - Co-regulation
 - IOSCO Principles
 - Matters arising from the Review Period
 - Legislative developments and future oversight reviews

MATTERS ARISING FROM THE REVIEW OF THE 2008 YEAR

17. The Commission is satisfied that NZX has either resolved or responded appropriately to matters arising from the 2008 review as shown in this table:

Recommendations /Actions	NZX response
<p>Relationship of NZX's expanding commercial activities to its regulatory function</p> <ul style="list-style-type: none"> As the NZX expands its commercial activities, the Commission has concerns that there is a risk of potential conflicts arising between NZX's commercial and regulatory functions. 	<p><i>Noted. NZX has appropriately managed conflicts of interest in accordance with its Conflicts Management Policy dated January 2008.</i></p> <p><i>NZX considers that dual delegation of the supervisory function from the NZX Board to the Chief Executive Officer and the Head of Market Supervision has been effective during the Review Period and has been competently discharged with no evidence that commercial concerns have affected the regulatory exercise of that delegation.</i></p>
<p>NZ Markets Disciplinary Tribunal</p> <ul style="list-style-type: none"> Implementation of meeting every four months between the CEO of NZX and the NZMDT chairman to improve communication between the entities NZX and NZMDT to establish a protocol for referrals from NZX to NZMDT to improve the transparency of the relationship. 	<p><i>NZX is in regular dialogue with the Chairman of NZMDT. NZX considers that communications between NZX and NZMDT are robust and effective.</i></p> <p><i>Both NZX and NZMDT agree that a protocol is not necessary and in fact could compromise the functions of both NZX and NZMDT. NZX and NZMDT have open dialogue about referrals being made in a manner that does not compromise the operations of NZX or NZMDT, which preserves NZX's lawful discretions and NZMDT's independence.</i></p>
<p>NZX's risk-based approach to supervision</p> <ul style="list-style-type: none"> Supervisory function to be resourced appropriately so that feedback can be provided to market participants in a timely way. 	<p><i>NZX firmly believes that there was adequate resourcing within the Market Supervision Group during the Review Period to enable NZX to carry out its obligations in relation to the Conduct Rules. This included provision of feedback to Market Participants in a timely manner. NZX adhered to agreed timetables and protocols in respect of its Market Participants, including delivery of inspection reports.</i></p>

<p>Responsibility for the supervisory function</p> <ul style="list-style-type: none">• The Commission has concerns relating to the dual delegation of responsibility for the supervisory function at NZX and the risk that this will create conflicts of interest that have the potential to compromise regulatory effectiveness.	<p><i>NZX considers that dual delegation of the supervisory function from the NZX Board to the Chief Executive Officer and the Head of Market Supervision has been effective during the Review Period and has been competently discharged with no evidence that commercial concerns have affected the regulatory exercise of that delegation.</i></p>
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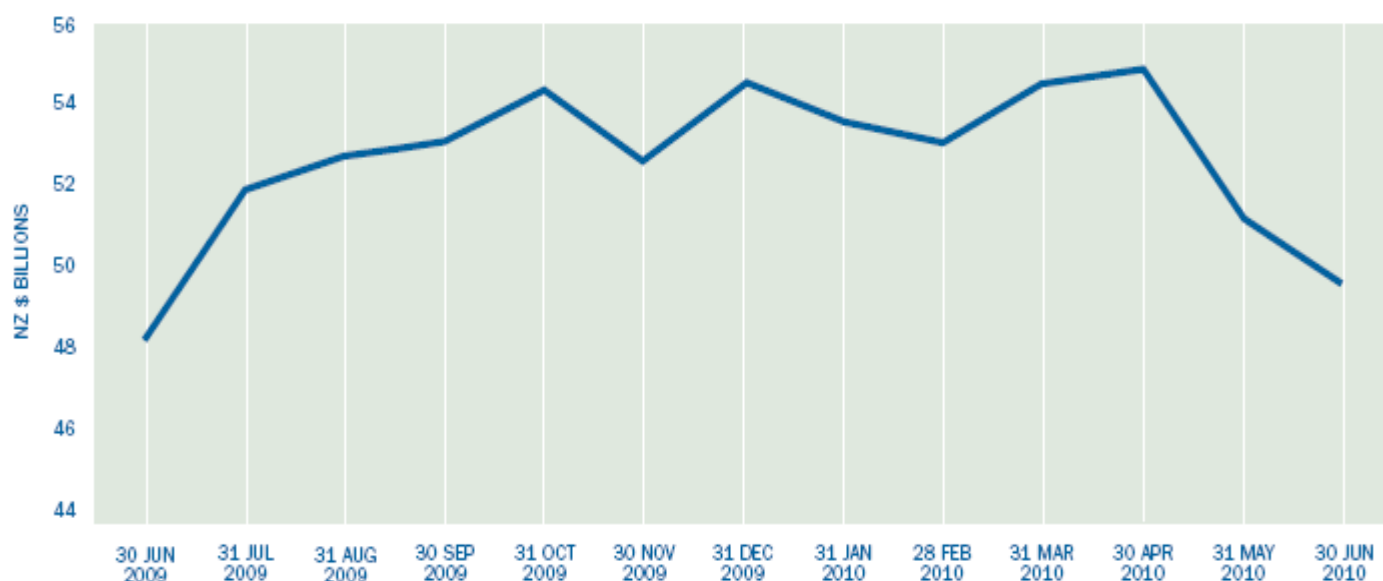
MARKET CONDITIONS AND NZX ACTIVITIES OVER THE REVIEW PERIOD

Equities

18. The market capitalisation of shares listed on the NZSX as at 30 June 2010 was \$49.6 billion. This was an increase of 2.5% on 2009's figure of \$48.4 billion. The smaller NZAX index decreased from \$600 million to \$390 million over the same period, a fall of 35%. NZX advises that market activity during the Review Period was consistent with global trends.
19. As at 30 June 2010, 152 Issuers were listed on the NZSX, compared with 156 at 30 June 2009. The NZAX had 27 Issuers at 30 June 2010, compared with 31 a year earlier.
20. The total new equity raised on the NZSX and NZAX during the year to 30 June 2010 was \$2.85 billion, compared with \$2.34 billion for the 2008/9 year.

Figure 1. NZSX market capitalisation

Source: NZX

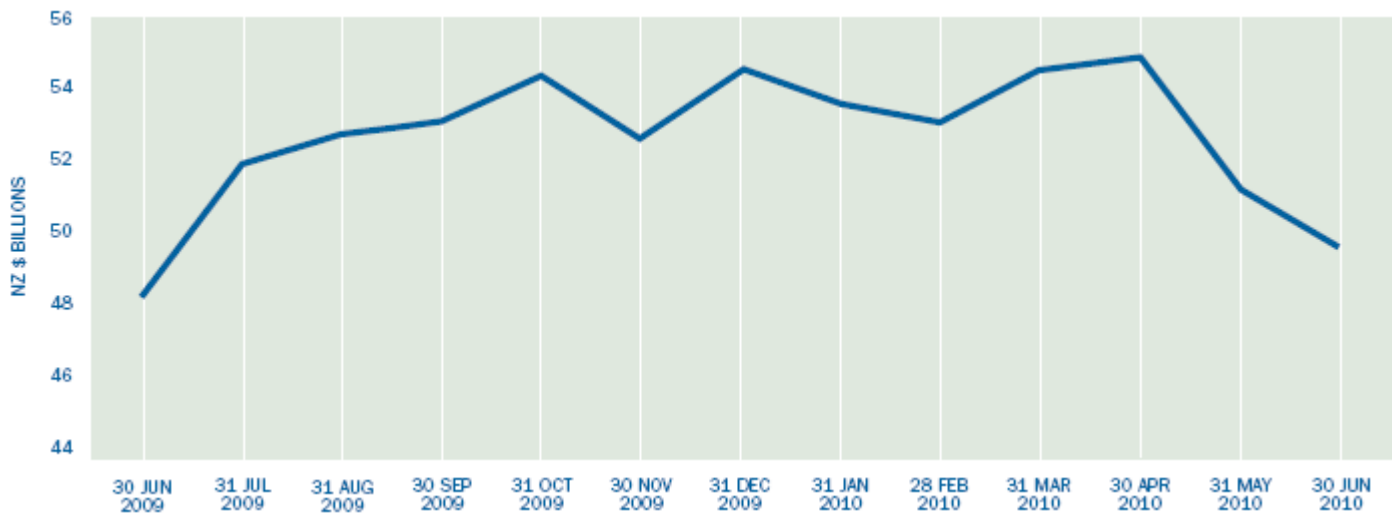


Debt

21. The value of the NZDX at 30 June 2010 was \$15.4 billion, a 4.4% increase from the same time last year.
22. Fifty-nine Issuers were listed on the NZDX at 30 June 2010, compared with 61 at 30 June 2009.
23. Total new debt raised on the NZDX during the year to 30 June 2010 was \$1.66 billion, compared with \$3.27 billion for the previous year.

Figure 2. NZDX market capitalisation

Source: NZX



CO-REGULATION

24. NZX is the only registered exchange in New Zealand. Under the co-regulatory regime set out in the Securities Markets Act 1988, the Commission monitors the performance of NZX's statutory responsibilities as described previously in paragraph 12.
25. As co-regulator, NZX is statutorily obliged to provide certain information requested by the Commission and to refer matters primarily relating to poor market conduct to the Commission. In observing these responsibilities, over the Review Period, NZX:
 - responded to 40 requests from the Commission in respect of trading data (27 in 2009 and 13 in 2010); and
 - referred 45 matters to the Commission pursuant to sections 36ZD and 36ZL of the Securities Markets Act 1988. (2009 year: 23 referrals, including 11 share price enquiries, two insider trading breaches, three market manipulation breaches, one misleading information breach, one directors and officers disclosure breach, one substantial security holder breach and four continuous disclosure breaches. 2010 year: 22 referrals, comprising nine share price enquiries, one insider trading breach, one misleading information breach, three market manipulation breaches, six substantial security holder breaches, and two continuous disclosure breaches).
26. NZX and the Commission are party to a Memorandum of Understanding (MOU) on their respective obligations and responsibilities to each other. NZX has expressed concern that since August 2009 the two have failed to observe the MOU's requirement to hold quarterly operational meetings. Members of the NZX Board who were asked for comment in relation to the operational relationship between NZX and the Commission thought it had improved since the Review Period. It was suggested that a more principles-based MOU, calling for meetings as required, might be beneficial.
27. The Commission agrees that, overall, the relationship between the parties has improved. It notes that as the MOU is dated February 2003, it is timely to revisit the terms, especially, in the light of forthcoming legislative changes.

IOSCO PRINCIPLES

28. In conducting the oversight review the Commission has been guided by international best practice and in particular the IOSCO Objectives and Principles of Securities Regulation (October 2003). While there are differences in each jurisdiction's approach, a number of standards can be taken from an overall assessment of the IOSCO Principles and overseas law and practice. These suggest that a stock exchange should:
- meet and maintain adequate standards of integrity and fitness for operating a market;
 - develop rules for the conduct of listed issuers and market participants;
 - develop and operate fair procedures for enforcing its rules;
 - conduct a fair, orderly, informed and efficient market;
 - maintain effective trading, clearing and settlement systems;
 - have the capacity for carrying out its regulatory functions and enforcing its rules; and
 - have procedures for managing conflicts of interest.
29. In New Zealand, rules development is addressed under the statutory approval and disallowance process for Conduct Rules in the Securities Markets Act 1988. The IOSCO Principles also address competition issues, which are outside the remit of the Securities Commission. Remaining matters are addressed in this review.

MATTERS ARISING FROM THE REVIEW PERIOD

Supervision of Participants and enforcement of the Participant Rules

Risk-based supervision

30. In 2006, NZX moved from annual inspections of all Market Participants to a risk-based approach to Participant supervision.
31. The Commission has been monitoring the effectiveness of the risk-based approach in its oversight reviews of NZX since the new method was implemented. The Review Period commences in the third year of application of the risk-based approach by NZX.
32. During the Review Period the processes undertaken by NZX in applying the risk-based approach were reviewed and altered. NZX redeveloped its process for scheduling and conducting onsite inspections of Participants to incorporate a new Capital and Prudential Inspection and the risk profiles of each Participant were updated and redesigned.
33. The Capital and Prudential Inspections are desk based inspections which are carried out over a two week period. A Participant is required to provide information such as bank reconciliations, trading data, daily liquid capital calculations and copies of breaches, error and complaints logs for a specified period following receipt of a request for such from NZX. The Participant has five working days to satisfy the request. NZX then commences a desk based review of the material provided and issues the Participant with an inspection report within a further five working day period. Where breaches are identified, Participants are given a timeframe within which to comment on and remedy the breach. The report also makes “good practice” recommendations.
34. NZX advises that the Capital and Prudential Inspection is an additional surveillance measure to supplement the scheduled onsite inspections, the targeted “special” or spot onsite inspections that are carried out by NZX and the daily and monthly prudential capital monitoring that NZX undertakes of capital adequacy reporting required from Market Participants pursuant to the Participant Rules. NZX conducted 23 Capital and Prudential Inspections (inspecting all Participants) during the Review Period (19 in 2009 and four in 2010).
35. The Commission notes that, with the exception of three targeted spot onsite inspections and one oversight action undertaken by NZX, no scheduled onsite inspections were carried out by NZX during the period from 1 September 2009 to 3 October 2010. NZX advises that all inspections that were carried out were completed in accordance with NZX protocols and timeframes. NZX advises that potential risk arising from this hiatus in scheduled onsite inspections was managed by the implementation of the Capital and Prudential Inspections (this area being identified by NZX as the key area of risk for Participants in the wake of the GFC), by the receipt and assessment of information provided by Market Participants wishing to be accredited to utilise the Clearing and Settlement System (including information that would have been gathered from the Participant during an onsite inspection) and by the

carrying out of three targeted spot inspections of Participants where risk was identified and one intensive oversight process in relation to the Participant assessed by NZX to be the highest risk. NZX also submits that as there have been no Participant failures during the Review Period, nor since, its method of managing the perceived risk arising from the lack of onsite inspections was appropriate.

36. The Capital and Prudential Inspections, by definition, focus on only one aspect of a Participant's business. The Commission supports this programme as an additional component of NZX's oversight of its Participants during the Review Period and beyond. However the Commission does not consider that the desk-based prudential reviews are a full substitute for more broad-based onsite supervision and inspection. The Commission is concerned that onsite inspections were not undertaken for a 13 month period commencing during the Review Period.
37. The Commission considers that onsite inspections are an essential part of the methodology for NZX's risk-based approach to supervision and the cessation of inspections during the period increased the risk of non-compliance. The Commission also notes that not all Participants have been accredited as Clearing Participants which means that risk surveillance carried out by NZX in relation to those parties who are not Clearing Participants was reduced during the Review Period. NZX advises that the Participants not accredited as Clearing Participants were "Advising Only Firms" which did not hold client funds or trade on the market. NZX categorises these types of Participant as lower risk than those that do hold client funds or trade on the market.
38. In the Commission's opinion resources should have been maintained by NZX to enable scheduled onsite inspections to be continued alongside the Capital and Prudential Inspections and the accreditation process that was undertaken in relation to the Clearing and Settlement System during the Review Period. The fact that there were no Participant failures during the Review Period does not mean that Participants did not breach the Participant Rules. The success of the risk-based method of market surveillance cannot be assessed solely upon the failure, or not, of Participants during a period. To do that would be to ignore non-compliance with the Participant Rules that may not result in the failure of a Participant but nonetheless may have an impact on the integrity of the market.

RECOMMENDED ACTION: NZX carries out scheduled onsite inspections in accordance with its risk-based surveillance methodology. The Commission notes this is already underway.

39. NZX advise that the redesigned risk profiles were a continuing response to the GFC and were undertaken to reweight the perceived risk factors for Participants. Higher risk weighting was given to financial vulnerability and trading exposure to other jurisdictions. The general risk categories remain the same however the key identifiers of risk within each category is more comprehensive.
40. Generally risk is broken down as follows (from highest weighting to lowest weighting):
 - Financial performance and liquid capital
 - Size and structure of Participant

- Business type
 - Complexity of business activities and operations
 - Market environment
 - Outcome of past inspections
41. NZX advises that its risk profiles are kept under review and remain subject to amendments on a continuing basis as further Participant information becomes available and as new risks to Participants are identified by NZX. NZX requests updated information annually from Participants. Information provided by Participants in relation to risk profiles is tested via onsite inspections.
42. Currently, following the launch of the Clearing and Settlement System, NZX advises that it is reviewing the risk profiles to update them with new information and reweight the profiles to address a new category which takes into account clearing and settlement.

Participant Rules

43. The Participant Rules were reviewed by NZX during the Review Period for amendments required as a result of the launch of the Clearing and Settlement System. The amendments became effective in August 2010.
44. During the Review Period, NZX considered the following matters require review and possible amendment in relation to the Participant Rules in addition to those required for the Clearing and Settlement System:
- Rule 21.5.2 (*Requiring NZX to notify all other Market Participants of a “Defaulter”*) NZX views the timing requirement for this notice as restricting its ability to manage counter party risk exposures, market risk and market confidence and proposes amendments as a result. This rule provides that where a Market Participant is a Defaulter (as defined in the rules) NZX shall notify all other Market Participants of that fact.
 - Rule 8.1.3 (*Comments to the Media*) NZX is considering deletion as it views this rule as one which is not appropriate for NZX to enforce. NZX consider this provision to be a hangover from pre-demutualisation of the exchange. This rule broadly requires that when Market Participants make comments to any news media or other parties on matters related to Securities listed on the market and other matters which are specified in the rule, the Market Participant must identify themselves.
 - Rule 8.10 (*Fidelity Guarantee Fund*) NZX is considering deletion of this rule on the basis that the fund is no longer required with the launch of the Clearing and Settlement System and the fund was not used during the Review Period. The Commission agrees that consideration of whether maintenance of a Fidelity Guarantee Fund is something that should continue is overdue. It is likely that the benefits that are derived from Participants “insuring” against the poor conduct of other Participants in this manner may be of little relevance in the current market and in practice the fund itself has no funds so currently the rule produces an expectation which may not be fulfilled (subject to NZX’s power to raise funds

from Participants for the Fidelity Guarantee Fund pursuant to the Participant Rules) The Commission notes that the Clearing and Settlement Rules do not provide for compensation for parties other than Clearing Participants as the Fidelity Guarantee Fund is intended to. The Commission supports consultation by NZX with stakeholders in relation to the ongoing availability and use of the Fidelity Fund.

45. During the Review Period NZX consulted on a variety of amendments to promote market liquidity (i.e. revising the market crossing rules and short selling rules) which remain under review.
46. NZX advises, and the Commission concurs, that the proposed amendments identified above were not able to be made to the Participant Rules during the Review Period due to the focus on processing amendments necessary for the Clearing and Settlement System. NZX advises that it will be considering whether these proposed amendments should be implemented during 2011.
47. As a result of debt trading investigations during the Review Period, NZX identified differing practices for reporting crossings on the NZDX and how margin and brokerage are reported via the trading system and on a client's contract note in relation to trading on the NZDX. As a result of these findings NZX advise that it is undertaking a review of these practices in consultation with the SIA working group to establish whether the practices are widespread or isolated incidents.
48. In late 2009 NZX conducted a review of Market Participants' conduct in respect of IPOs. This arose from concerns about IPOs in 2009 that had either progressed but not been as successful as could reasonably have been anticipated or did not proceed at all. NZX had become concerned that Participants were not acting in a manner which promoted participation in IPOs by the market and retail investors. As a result of consultation a guidance note as to IPO good broking practice was prepared. Whilst drafted in 2009 and further refined in early 2010, the guidance note has not been introduced formally to the market. NZX has advised the Commission that it informed Market Participants that this guidance may be introduced if practices do not improve. NZX considers that the best result is for Participants to engender changes themselves in their practice without the "stick of additional regulation". As there has only been one IPO in the New Zealand market (completed in the first half of 2010) since development of the guidance note, NZX are still monitoring Participant practices.
49. The Commission agrees with NZX's position in relation to encouraging the development of good practices where possible. However, should further regulation be required, the Commission's preference would be for this to be achieved through amendment to the Participant Rules rather than by the publication of a guidance note. The Commission understands that the purpose of a guidance note is to clarify the purpose or meaning of a rule, including the exercise of any discretion under the rule. While the concept of "good broking practice" in the Participant Rules is subject to broad interpretation, the Commission does not believe it is desirable for this to take the place of more transparent obligations where these are needed. If further regulation is required because the rules can be interpreted in a manner that is not viewed as appropriate by NZX then the rules should be amended.

50. Given the relatively low level of IPO activity the Commission supports NZX's continued monitoring of practices.

Waivers and rulings

51. NZX advise that there were no changes to the method of processing waiver and ruling applications during the Review Period. NZX processed 22 waiver and ruling applications (18 in 2009 and four in 2010) in relation to Market Participants during the Review Period. Of these, NZX declined three applications. This number of waivers is consistent with activity during 2008 during which time 31 applications were processed with one being declined and one being granted in part.

Complaints

52. During the Review Period, NZX processed, and where necessary investigated, 19 complaints regarding the conduct of Market Participants (13 in 2009 and six in 2010). Of these, one complaint was referred to the Commission and one was referred to NZMDT. NZX advises that during the Review Period response times for some complaints were outside the target set by NZX due to the need to allocate resources to more urgent projects.

Breaches of the Participant Rules

53. During the Review Period, NZX identified 270 breaches of the Participant Rules. NZX advised that identification of breaches is via Participant self-reporting, complaints, NZX market surveillance and information obtained in the course of inspections. Serious breaches of the Participant Rules are referred to NZMDT for disciplinary action.

Supervision of Issuers and enforcement of the Listing Rules

Listing Rules

54. In the previous Review Period a new policy on back-door and reverse listings was adopted by NZX and implemented via a guidance note with the objective of improving the processes by requiring: (i) the production of a profile for the post-transaction entity, (ii) director certifications in respect of the information in the profile and to certify that all material information has been disclosed and (iii) a change in fees to align them with those payable in respect of a conventional listing. A back-door listing takes place when a listed company, with little or no active business (a trading shell), acquires an unlisted company which is seeking to become listed. A reverse listing involves a shell company that lists on the market with the aim of identifying a business to acquire. NZX advises that the required outcome has been achieved, that effected parties receive a better standard of documentation than was previously the case and that sufficient information is provided to the market in respect of target companies and post-transaction issuers.
55. In April 2009 changes were made to the Listing Rules which were designed to enable Issuers to react flexibly and quickly to difficult market conditions, in particular in the critical area of capital raising. The changes made are summarised below:

- **Private placements** - Amendments to NZSX Rules 7.3.5 and 7.3.9, with corresponding amendments to NZAX Rules 7.3.5 and 7.3.9, with the effects of:
 - increasing the maximum number of new equity securities an Issuer can issue by private placements in the course of one year without requiring shareholder approval from 15% of the class of securities to 20% (or an increase of 20% to 25% in the case of NZAX Issuers); and
 - permitting directors, their associated persons and employees of Issuers to participate in private placements subject to certain conditions.
- **Pricing of offers of new securities** - Amendment to NZSX Rule 8.1.3, with no equivalent NZAX rule. This amendment altered the minimum pricing level for new securities from 90% of a volume weighted average market price for the securities concerned based on the previous 20 days' trading, to 85% calculated over the previous five business days.
- **Materiality of related party transactions** – Amendments to NZSX Rule 9.2.2 and NZAX Rule 9.2.2. These amendments increased the threshold of certain classes of transaction that Issuers may enter into with related parties without needing to obtain shareholder approval. For acquisitions or disposals of assets, issues or buybacks of securities, lending and borrowing, and the giving of guarantees and indemnities the threshold (the maximum size of transaction permitted without shareholder approval) was lifted from 5% to 10% of market capitalisation, and for service provision agreements from 0.5% to 1%.
- **Remuneration of directors by stocks** - Amendments to NZSX Rules 3.5.1 and 7.3.7, and NZAX Rules 3.4.1 and 7.3.7. These amendments provided for Issuers to pay directors with stock, subject to certain safeguards.
- **Reduced timetables for rights issues** - Amendments to NZSX Rules 7.10.2 and 7.10.10, and NZAX Rules 7.9.2 and 7.9.9. These amendments reduced the time taken to complete rights offers from 28 business days to 17 business days.
- **Employee share schemes and stock issuance** – Amendments to NZSX Rule 7.6.1(f) and NZAX Rule 7.6.1(f)(i). These amendments removed the restriction on share buybacks from employees (other than employees who are also directors or associated persons of directors of the Issuer in question).
- **Financial assistance for the acquisition of its shares by employees** – Amendments to NZSX Rule 7.6.4(b)(ii) and NZAX Rule 7.6.1(b). These amendments increased the level of financial assistance that issuers are able to provide to staff purchasing securities from 5% to 10% of an issuer's average market capitalisation.

56. These changes were implemented after a consultation process with stakeholders and in liaison with the Commission and were implemented subject to review after one year. The Commission has undertaken a public consultation to obtain feedback as to the effectiveness of the changes. Submissions received by the Commission did not

reveal evidence of abuse of these rule changes. NZX advises that from its perspective the changes have been effective and were a cogent and efficient response to a serious financial situation.

57. The Listing Rules were also amended during the Review Period as a result of the introduction of the Clearing and Settlement System. Included in that update to the rules were amendments to make the rules consistent with legislative developments.

NZX proposals for further amendments to the Listing Rules

58. NZX submits that the Dual Listed Issuer regime in the rules is too narrow and should be broadened beyond the ASX/Australia so that a Dual Listed Issuer includes any Issuer which NZX determines to be listed on, and compliant with, any recognised exchange with acceptable and comparable oversight frameworks and information disclosure (e.g. such as TSX or FTSE). NZX believes this flexibility is necessary to attract such listings on the NZSX without compromising any regulatory outcomes when such stocks are listed on exchanges with robust regimes.
59. A potential weakness in the enforcement provisions of the Listing Rules raised by NZX during the oversight review is that breaches of the Listing Rules which are determined by NZMDT can only be penalised by way of fining the Issuer or suspension of the Issuer from trading. NZX has expressed concern that the discipline process therefore penalises shareholders rather than directors who are responsible for the conduct. In relation to substantive continuous disclosure breaches, suspected market manipulation and insider trading, NZX refers matters to the Commission which has jurisdiction in certain circumstances to issue proceedings against directors pursuant to the Securities Markets Act 1988.
60. The Commission notes that where NZMDT imposes a financial penalty on an Issuer, the directors of the entity should be accountable to the shareholders for any acts or omissions that brought about the breach. Beyond this, direct liability for directors in relation to breaches of the Listing Rules would be available only if NZX were amend the Listing Rules to require directors to undertake to comply with the rules in the same manner as Issuers.

Waivers and rulings

61. During the Review period 253 waiver and ruling applications in relation to the Listing Rules were processed by NZX (209 in the 2009 year and 44 in 2010). 195 waiver and ruling applications were processed by NZX in 2008. Of the applications made during the Review Period, four were declined (in relation to periodic reporting rules) and a further seven were withdrawn following NZX advice that they would be declined. All waivers are subject to conditions.
62. NZX advise that all waivers were delivered within NZX timeframes and in accordance with NZX protocols.
63. Waiver applications are considered by a division of generally three lawyers in the NZX Market Supervision Group, one of those being a senior team member, unless the

waiver is of such a straightforward nature, or where there is ample precedent, that it can be dealt with by one lawyer.

64. NZX advise that waivers sought during the Review Period were not concentrated on any particular aspect of the Listing Rules.
65. During 2010, NZX implemented a conditional waivers log, in relation to conditions with fixed timeframes for satisfaction, to use as a method of monitoring adherence to conditions of waivers which have fixed timeframes for compliance. NZX advise that it is still trialling this new initiative. Prior to the development of the conditional waivers log, NZX relied on self reporting by Issuers and the deterrence of potential disciplinary action to ensure compliance with waiver conditions.

Complaints

66. During the Review Period NZX processed, and where necessary investigated, 33 complaints in respect of the conduct of Issuers (22 in 2009 and 11 in 2010). Of these, three matters were referred to the Commission. NZX advise that all complaints were processed in accordance with NZX protocols and within NZX timeframes.

Continuous disclosure supervision

Consultation

67. NZX responded to concerns in the market regarding the operation of the continuous disclosure regime by inviting Chief Executives and Chief Financial Officers of Issuers to a meeting in Auckland in May 2010 to discuss their views as to the operation of the continuous disclosure regime. As a result of this meeting, consultation with the Commission and consideration of the impact of proposed securities law reforms, NZX produced an amended guidance note to the market for consultation in October 2010.
68. On an annual basis NZX surveys Issuers who have not filed any announcements to the market in the previous six months, other than those required due to periodic reporting obligations. NZX asks Issuers who are captured to advise NZX whether they remain in compliance with their continuous disclosure obligations. This is a new surveillance tool.

Periodic reporting breaches

69. During the Review Period, NZX identified a number of periodic reporting breaches. NZX made efforts to reduce this by sending out reporting schedules to Issuers at the beginning of the year and by calling Issuers ahead of time to enquire as to upcoming reporting dates. NZX advise that this proactive method, combined with successful referrals of such breaches to NZMDT has resulted in the reduction of breaches over the course of the Review Period in respect of periodic reporting.

Price enquiries/ Continuous disclosure enquiries

70. There were 54 continuous disclosure enquiries undertaken by NZX during the Review Period. From this, 19 price enquiries were made of Issuers and three matters were

referred to the Commission. When price enquiries are made, both the letter of enquiry and the letter of response from the relevant Issuer are published to the market by NZX.

Trading halts

71. NZX operates a system whereby trading halts are placed on securities for between 10 and 15 minutes post announcement, to allow Market Participants time to digest market sensitive announcements and to mitigate against volatility in the market post announcement.
72. Trading halts are also implemented by NZX in accordance with the Listing Rules. During the Review Period 90 trading halts were implemented by NZX (70 in 2009 and 20 in 2010).

Breaches of the Listing Rules

73. During the Review Period, NZX identified 28 breaches of the Listing Rules (21 in 2009 and seven in 2010). Breaches of the Listing Rules are primarily identified via NZX market surveillance activities, Issuer self-reporting or complaints. Two Issuers were delisted in 2010 as a result of breaches of the Listing Rules following findings of breach by NZMDT.

Allocation of human, technological and financial resources as it affects performance of the regulatory functions of NZX

Human resources

74. In the Market Supervision Group, there is a team of between 19 and 21 people at any one time. During the Review Period, NZX advise that turnover in the Market Supervision Group of NZX was 24% compared to turnover of 9% across all of the NZX business. NZX advises that turnover in the Market Supervision Group was the result of a restructure in early 2009 aimed at improving the skill base in the surveillance and compliance areas of the Market Supervision Group.
75. During the Review Period all employees in the Market Supervision Group were full time with the exception of two lawyers who commenced the Review Period as part time employees becoming full time by the close of the Review Period.
76. The Commission acknowledges that NZX, like other employers of professionals, such as lawyers and accountants, faced recruitment challenges during the Review Period in relation to the Market Supervision Group as a result of the lack of depth of suitably skilled and experienced candidates in the New Zealand market. NZX advises that as a result the recruitment process in many cases took longer than expected to fill some positions and recruitment of candidates from offshore was necessary. The outcome of the recruitments during the Review Period was positive in NZX's view, and resulted in a team with increased experience and qualification. NZX advises that occasionally, as special projects require, workload can be managed via secondment from legal service providers.

77. NZX advise that it considers that the resourcing of NZX's Market Supervision Group was adequate to discharge its obligations to ensure compliance with the Conduct Rules and that resourcing of the Market Supervision Group is a matter which is actively monitored by the Board of NZX via dedicated discussions between the Board and the Head of Market Supervision at each Board meeting.
78. NZX was unable to provide the Commission with data which recorded the proportion of time spent by supervision staff on regulatory matters as opposed to commercial matters as NZX does not record time spent on matters by staff, outside of specific purposes, such as work for which fees are levied, e.g. waivers and rulings. Without that data it is very difficult for the Commission to independently conclude that there is satisfactory resource in the Market Supervision Group.

RECOMMENDED ACTION: NZX to implement a means of recording actual human and other resources devoted to market supervision in order to increase transparency of resourcing.

Technology

79. During the Review Period NZX undertook system testing of an upgrade to its SMARTS market surveillance software. The testing was successful, and the upgrade has now been completed. The advantage of the new SMARTS package from NZX's perspective is that the alert package is constantly modified and improved by the SMARTS system provider from information and research that the provider undertakes. NZX advises that the upgrade of the system provides more efficiency (in that NZX is no longer responsible for maintaining its own version of alerts) and the alerts evolve with the market as SMARTS upgrades its alert package.
80. During the Review Period, NZX's Trayport and MAP systems were stable and maintained near perfect "uptimes".
81. NZX advises that SMARTS operated on the same hours of operation as Trayport. NZX experienced a three hour outage in April 2010 due to an external SMARTS system failure to allow NZX to connect to its remote server. In such circumstances, NZX advise that surveillance was undertaken manually and by using other surveillance tools (e.g. IRESS data feeds).

Financial resources

82. NZX advises that its Market Supervision Group does not have a budget or firm financial targets and that the performance of the Market Supervision Group is not assessed against financial objectives.

Internal practices and procedures associated with investigations, price enquiries, complaints-handling and referrals;

83. NZX advise that its complaints process did not change during the Review Period and currently remains the same as throughout the Review Period. The Financial Service Providers (Registration and Dispute Resolutions) Act 2008 came into force at the

beginning of December 2010. This law requires, among other things, that advisers (which include Participants) belong to an approved dispute resolution scheme. The Commission considers that the complaints procedure of NZX may require amendment to acknowledge this new legislation and the dispute resolution options available to complainants.

84. NZX advise that whilst its complaints procedures will not be updated on account of the new law there may be a need to amend the Participant Rules to ensure that any findings against a Participant as a result of the dispute resolution process are reported to NZX and it will also be updating its website to provide further information. NZX advises it is consulting with stakeholders in relation to this matter.

RECOMMENDED ACTION: NZX to complete its review of any changes to be made to the Participant Rules and its communications as a result of the dispute resolution provisions contained in the Financial Service Providers (Registration and Dispute Resolutions) Act 2008 for consideration during 2011.

Discipline practices, procedures and resources

New Zealand Markets Disciplinary Tribunal

85. The NZMDT is an independent regulatory body established under the NZMDT Rules.
86. The Tribunal's principal role is to determine whether there has been a breach of the NZX Conduct Rules in matters referred to it by the NZX. In the event that the Tribunal finds a breach, its secondary role is to assess and impose penalties.
87. During the Review Period a new Listed Issuer member, Alison Paterson, was appointed to the Tribunal in May 2010 following the resignation of Mark Verbiest in January 2010, when he became a member of the Commission. Victoria Heine and Laurie Mayne also stood down as Legal representatives. Stephen Kós QC has recently resigned from his position as chairman and member of NZMDT upon his appointment as a High Court Judge. A new chairman will be appointed at the Tribunal's annual general meeting in June 2011. A new issuer representative and a market participant representative are also in the process of being appointed.
88. The Tribunal advises that it was adequately resourced by NZX and that funding has been sufficient to enable improvements in the operational processes of the Tribunal over the Review Period.
89. In the first six months of 2009 the Tribunal received one referral from NZX however following the appointment of a new Head of Market Supervision at NZX in August 2009, referrals since late 2009 have increased to a level that the Tribunal felt was of the nature and level it would expect to see.
90. NZMDT notes in its 2009 Annual Report that NZX has advised it that policy formation and input into policy formation is not part of the mandate of the Tribunal.

The Tribunal disagrees on the basis that it is a body established under the NZMDT Rules with the specific purpose of being independent of NZX and with the express power to “suggest to NZX and consult with NZX on the amendment of the Rules”.

91. NZX advises that it *“considers that the determination of NZX’s position on capital markets policy is solely the remit of the Board of NZX. The current position is that NZMDT is part of, and funded by NZX, although operated independently. NZX believes the principal function of NZMDT is to enforce and provide remedies for breaches of the Conduct Rules referred to it as an independent disciplinary body. As such, NZMDT has an operational, and not policy, focus. NZX does not believe it is appropriate for NZMDT to take positions on policy matters and for the funds of NZX (Discipline) Fund to be applied towards defraying the expenses of NZMDT in this regard. NZX believes these funds would be better applied towards education initiatives and the costs of disciplinary proceedings.”*
92. NZX submits that it *“does not see NZMDT as having a policy function over and above the requirement to consult pursuant to NZMDT Rules 1.3 and 1.4, where the Tribunal can suggest Rule amendments to NZX. NZX believes the intent and purpose of NZMDT Rule 4.1.1(h) was to give the Tribunal the opportunity to suggest improvements to specific Rules where issues were identified by the Tribunal in their day to day application.”*
93. The Commission understands that this debate arose in 2009 when the Tribunal expressed a wish to examine the workings of counterpart bodies in other jurisdictions, to identify operational improvements that could be recommended to NZX. The debate was put to one side while new securities legislation was developed, but was revived when the Tribunal provided comments to the Ministry of Economic Development on a draft version of the Financial Markets (Regulators and KiwiSaver) Bill 2010. As introduced, that Bill proposed the implementation of a publicly funded and independent Rulings Panel to replace the NZMDT. The particular circumstances giving rise to the debate are therefore unique and unusual given that legislative change of this nature occurs rarely. The Commission expects there will be ongoing dialogue between NZX and NZMDT in relation to the practical impact of NZMDT’s interpretation of the NZMDT Rules and the jurisdiction of the Tribunal. The Commission encourages NZX to consider the unique and independent role and experience of the Tribunal in discussing these matters with a view to resolution.

Arrangements for market infrastructure development and maintenance

94. During the Review Period the following developments in market infrastructure occurred:
- Preparation for the launch of NZX Derivatives Market in September 2010
 - Preparation for the launch of Clearing and Settlement System in September 2010
95. NZX advise that during the Review Period, three members from the Market Supervision Group were engaged on projects relating to the Derivatives Market and the Clearing and Settlement System, either in a full time or part time capacity. NZX

advise that this project work did not impact on the supervision function during Review Period. We note the observations in paragraph 78.

96. NZX has obligations pursuant to the Authorised Futures Exchange (NZX Limited) Notice 2010 to do all things necessary to ensure that the Derivatives Market operates in a fair, orderly and transparent manner; to have adequate arrangements for supervising the Derivatives Market including arrangements for handling conflicts of interest, monitoring the conduct of participants, enforcing compliance with the relevant conduct rules and to have sufficient resources to operate the Derivatives Market properly and for the required supervisory arrangement to be provided.¹ NZX must report annually to the Commission on how well it carries out its obligations. The first reporting period in relation to the Derivatives Market falls outside the Review Period and therefore this Oversight Review will not report in relation to NZX's supervision of the Derivatives Market. It is anticipated that the FMA will include its report on NZX's supervision of the Derivatives Market in future oversight reports of NZX as a regulated exchange.
97. Oversight of the Settlement and Clearing System is undertaken by the Reserve Bank and the Commission jointly pursuant to the Reserve Bank of New Zealand (Designated Settlement System—NZCDC) Order 2010 and is not included in the oversight of NZX as a regulated exchange.

Corporate governance arrangements, including board composition, policy setting, crisis response and oversight of executive management, with reference to regulatory standards relating to governance of demutualised exchanges under IOSCO and other international principles

98. During the Review Period the Board of NZX established the Policy, Stakeholder and Risk Committee. The purposes of this Committee are to: bring a systematic approach to regulatory policy formation; ensure appropriate governance structures and systems are in place for the management of external stakeholder and Participant risks; and deal with any other matters referred to it by the Board.
99. As identified in the previous oversight review report, the NZX Conflicts Management Policy dated 20 January 2008 contemplates that the dual role of market operator and supervisor may lead to a conflict or perception of a conflict between the regulatory and commercial function of NZX, because commercial interests have the objective to maximise value for shareholders whereas the regulatory obligation as a market operator is to utilise resources to supervise its market.
100. To counteract the possibility of conflict or the perception of it, the policy requires that commercial interests should not be allowed to influence supervisory decision making; that supervisory activity and information is to be quarantined from commercial activity, and that supervisory activity and decision making must be consistent and transparent.

¹ Section 7 of the Authorised Futures Exchange (NZX Limited) Notice 2010.

101. The Board of NZX has delegated authority to both the Chief Executive and the Head of Market Supervision to make decisions in relation to the regulatory functions of NZX.
102. In the 2008 oversight report the Commission noted its concern that the dual delegation imbeds an inevitable ongoing source of conflicts of interest between the NZX's commercial and regulatory roles. The 2008 report also noted the structure was not consistent with the international best practice of formal separation of the commercial and regulatory functions of demutualised exchanges.
103. Whilst no issues have arisen during the Review Period in relation to the dual delegation the Commission recommends that future oversight reviews of NZX continue to monitor and report on this matter because, in the Commission's opinion, the dual delegation does not conform to best practice internationally and as a result there is an ongoing possibility that the existing structure leaves the supervision function open to possible compromise.
104. As the commercial activities of NZX, such as the information businesses, grow and become a greater proportion of the overall activities of NZX it is foreseeable that greater focus and resource will be directed to those areas. In that situation, it remains important to ensure that the priority of the market supervision function is maintained and resourced appropriately. The Commission suggests this could be done by removing the dual delegation structure and retaining a single delegation to the Head of Market Supervision with a direct reporting line to the Board of NZX. In this way the supervisory function would be empowered and the possibility of erosion from the commercial function of NZX diminished.

NZX's commercial activities versus regulatory function

105. During the Review Period NZX further expanded its commercial interests in various information and data services and markets.
106. During the Review Period NZX acquired the following businesses:
- Country-wide Publications Limited, an agricultural publishing service;
 - CLEAR Group, a grain exchange and information business
 - Australian Crop Forecasters Pty Limited, Melbourne
 - M-Co, operator of New Zealand's electricity and gas markets.
107. The NZX 2010 Annual Report records the revenue mix moving to a stable 40% Information, 40% Markets and 20% Infrastructure over 2010. The Chief Executive of NZX also made the statements in the 2010 Annual Report that "*NZX is truly integrated information, markets and infrastructure company, not merely a 'stock exchange'*" and that "*NZX is a global leader in the provision of market information*".
108. NZX has appropriately managed the conflicts of interest between its commercial and regulatory functions throughout the Review Period and the Commission notes that during the Review Period, an alleged breach of the Listing Rules by an NZX subsidiary was referred to the Special Division by the Market Supervision Group of NZX.

109. The Commission remains concerned with the risk of potential conflicts that might arise between NZX's regulatory and commercial functions as NZX expands its commercial activities. While the Commission is not aware of any such conflicts during the Review Period or at this time, it considers that this structure and the outcomes from it should continue to be scrutinised in future oversight reviews of NZX.

Special Division of the NZMDT

110. The Special Division is an independent body established under the NZMDT Rules which regulates NZX as an Issuer in the same way that NZX regulates other Issuers.
111. During the Review Period there were no changes to membership.
112. In June 2010 the Special Division undertook a review of the procedures regarding the referral of SMARTS alerts by NZX to the Special Division. This review was undertaken to clarify when alerts and abnormal trading activity (in circumstances where no SMARTS alert has fired) in respect of units of the funds managed by Smartshares Limited should be referred to the Special Division and resulted in amendments to the Special Division procedures.
113. The Special Division advises that it is sufficiently resourced by NZX to exercise its powers and functions in a manner consistent with its objective.
114. No significant matters arose concerning the Special Division during the Review Period.

LEGISLATIVE DEVELOPMENTS AND FUTURE OVERSIGHT REVIEWS

115. The FMA will replace the Commission on 1 May 2011 pursuant to its founding Act, the Financial Markets Authority Act 2011, which will come into force on 1 May 2011. The Securities Markets Amendment Act 2011 will also come into force on 1 May 2011 providing a statutory oversight regime which places specific reporting obligations on both the FMA and the NZX.
116. The Securities Markets Amendment Act 2011 provides that a registered exchange must:
- a) *to the extent that it is reasonably practicable do all things necessary to ensure that each of its registered markets is a fair, orderly, and transparent market; and*
 - b) *have adequate arrangements for operating its registered markets, including arrangements -*
 - *for handling conflicts between the commercial interests of the registered exchange and the need for the registered exchange to ensure that the markets operate in the way referred to in paragraph (a); and*
 - *for monitoring the conduct of exchange participants on or in relation to the markets; and*
 - *for enforcing compliance with the relevant market rules; and*
 - *that ensure there is a sufficiently independent adjudicative body to adjudicate on contraventions of market rules that are referred to it; and*
 - c) *have sufficient resources (including financial, technological, and human resources) to operate its registered markets.*
117. The registered exchange must, within three months of the end of its financial year, give a report to the FMA and the Minister of Commerce on the extent to which it has complied, in the preceding financial year, with the above obligations.
118. The FMA must provide a written report on the review to the Minister of Commerce and the registered exchange, which may be published on the FMA's website.

CONCLUSION

119. The Commission's overall conclusion is that NZX is satisfying its obligation to operate its markets in accordance with its Conduct Rules.
120. The Commission's findings are set out below.

Matters arising from the 2008 year

121. The Commission is satisfied that NZX has either resolved or responded appropriately to all matters that arose from the 2008 review. The Commission considers that matters relating to the commercial/regulatory functions of NZX and the dual delegation of the supervisory function should be kept under review as recommended in this report.

Supervision of Participants and enforcement of the Participant Rules

122. The Commission is satisfied with NZX's performance in the supervision of Participants and enforcement of the Participant Rules. The risk-based approach remains an appropriate method for assessing the risk of a Participant's non-compliance with the Participant Rules.
123. The Commission is concerned that scheduled onsite inspections were not undertaken for a 13 month period commencing during the Review Period. The Commission considers that scheduled onsite inspections are an essential part of the methodology for NZX's risk-based approach to supervision and the cessation of inspections during the period increased the risk of non-compliance.
124. The Commission recommends that NZX ensures adequate resources are maintained at all times to enable essential supervisory functions, such as scheduled onsite inspections, to be carried out despite other competing matters requiring the attention of the Market Supervision Group.
125. The Commission acknowledges that NZX identified and took steps to manage the risk associated with the reduction in scheduled onsite inspections during the Review Period. The Commission also observes that scheduled onsite inspections resumed in October 2010.

Supervision of listed issuers and enforcement of the Listing Rules

126. The Commission is satisfied with NZX's performance in the supervision of Issuers and the enforcement of the Listing Rules.

Allocation of human, technological and financial resources as it affects performance of the regulatory functions of NZX

127. Subject to the concern expressed in relation to scheduled onsite inspections, and the lack of data relevant to the utilisation of staff in the Market Supervision Group, overall the Commission is satisfied that the allocation of human, technological and financial resources to the regulatory function of NZX has been sufficient during the Review Period to enable that function to meet its objectives.

Internal practices and procedures associated with investigations, price enquiries, complaints-handling and referrals

128. The Commission has not identified any practices or procedures associated with investigations, price enquiries, complaints-handling or referrals which require particular mention and is satisfied that the practices and procedures in place during the Review Period were satisfactory to enable NZX to carry out its supervision function.

Discipline practices, procedures and resources

129. The Commission is satisfied with NZMDT's execution of its function as an independent disciplinary body dealing with matters referred by NZX.

Arrangements for market infrastructure development and maintenance

130. Subject to the concern expressed regarding scheduled onsite inspections, the Commission is satisfied that work in relation to the Derivatives Market and the Clearing and Settlement System undertaken by members of the Market Supervision Group of NZX has not prevented the NZX from carrying out its role as front-line regulator.

Corporate governance arrangements, including board composition, policy setting, crisis response and oversight of executive management, with reference to regulatory standards relating to governance of demutualised exchanges under IOSCO and other international principles

131. The Commission is satisfied that the initiatives undertaken by NZX to ensure that any actual or perceived conflict of interest, that arises from the dual delegation of responsibility for the supervisory function to the Chief Executive and the Head of Market Supervision, is either mitigated or eliminated has been effective during the Review Period and that there is no evidence that any conflict has compromised the ability of the Market Supervision Group to supervise Participants and Issuers effectively during the Review Period.
132. However, as it is intrinsic in the current structure that a conflict of interest could arise, the Commission recommends that this structure and its outcomes remain under review in further oversight reviews. The Commission also recommends that NZX consider the merits of removing the dual delegation and retaining a single delegation to the Head of Market Supervision as a method of reducing the potential for conflicts of interest between the commercial and supervisory functions of NZX.

NZX's commercial activities versus regulatory function

133. As NZX's interests expand beyond the core business of running an exchange toward other businesses associated with providing information and data services, it is possible that conflicts of interest could arise between NZX's commercial and regulatory functions.
134. The Commission is satisfied with the Special Division's execution of its function as an independent regulator of NZX as an Issuer.

Recommended Actions

135. NZX and the Commission have agreed the following actions arising out of the Review Period.
- *NZX carries out scheduled onsite inspections in accordance with its methodology. The Commission notes that NZX is already underway with this. (page15)*
 - *NZX to implement a means of recording actual human and other resources devoted to market supervision in order to increase transparency of resourcing. (page 23)*
 - *NZX to complete its review of any changes (if any) to be made to the Participant Rules and its communications as a result of the dispute resolution provisions contained in the Financial Service Providers (Registration and Dispute Resolutions) Act 2008 during 2011. (page 24)*

APPENDIX 1: GLOSSARY OF KEY TERMS AND ABBREVIATIONS

<i>Clearing and Settlement System</i>	the clearing and settlement system operated by NZCDC, which is a wholly owned subsidiary of NZX.
<i>Clearing Participant</i>	an organisation accredited by NZX to utilise the Clearing and Settlement System.
Commission	the Securities Commission of New Zealand.
<i>Conduct Rules</i>	The Participant Rules and Listing Rules of NZX.
<i>FMA</i>	Financial Markets Authority.
<i>GFC</i>	Global Financial Crisis.
<i>IOSCO</i>	International Organization of Securities Commissions.
<i>IPO</i>	Initial public offering.
<i>Issuer</i>	Any entity which is or has been listed on the NZSX, NZAX or the NZDX.
<i>Listing Rules</i>	Rules made by NZX that govern the conduct of Issuers listed on NZX's markets, approved as Listing Rules under the Securities Markets Act 1988.
<i>Market Participant</i>	An organisation accredited by NZX to participate in the securities markets that NZX operates.
<i>Market Supervision Group</i>	A group within NZX led by the Head of Market Supervision comprising four teams – Issuer Regulation, Participant Compliance, Market Surveillance and Client and Market Services.
<i>NZAX</i>	New Zealand Alternative Stock Market.
<i>NZCDC</i>	New Zealand Clearing and Depository Corporation Limited.
<i>NZMDT</i>	A disciplinary body constituted by NZX under the NZMDT Rules (formerly called NZX Discipline.)
<i>NZMDT Rules</i>	The New Zealand Markets Disciplinary Tribunal Rules as made by NZX.
<i>NZSX</i>	New Zealand Stock Market.

<i>NZX</i>	NZX Limited.
<i>Participant</i>	A Market Participant.
<i>Participant Rules</i>	Rules made by NZX that govern the conduct of business on securities markets operated by NZX and persons authorised to undertake trading activities on those markets, approved as Business Rules under the Securities Markets Act 1988.
<i>Review Period</i>	From, and including, 1 January 2009 to, and including, 30 June 2010.
<i>SIA</i>	Securities Industry Association, the representative body for Market Participants.
<i>Special Division</i>	The division of the NZMDT that exercises the powers and functions of NZX in relation to NZX or a related entity as an Issuer.
<i>Tribunal</i>	NZMDT.

APPENDIX 2: SCOPE OF REVIEW

Section 36G of the Securities Markets Act 1988 states that NZX must operate each of its securities markets in accordance with approved Conduct Rules for that market. The Conduct Rules include Listing Rules and Participant Rules that govern the conduct of persons authorised to undertake trading activities on the market.

NZX's obligations under section 36G are to secure compliance with its Listing Rules and Participant Rules, and to perform any obligations that NZX is subject to under those rules. To do this, NZX has a Market Supervision Group with responsibilities for discharging NZX's regulatory function. The NZMDT Rules establish a dedicated body, the NZMDT, to determine questions of non-compliance with the Listing Rules or Participant Rules. Decisions can be appealed to the Appeal Panel. An independent body, the Special Division of the NZMDT, exercises the powers and functions of NZX in relation to NZX as an Issuer and its related entities.

The Commission has statutory functions to review practices relating to securities and activities on securities markets, and to comment on these. In relation to NZX, performance of these functions requires the Commission to keep under review and comment on NZX's obligations as a registered exchange. This oversight review was conducted under sections 10(b), 10(c) and 10(caa) of the Securities Act 1978.

In assessing NZX's compliance with its supervisory functions as they existed during the Review Period the Commission considered NZX's performance in the following areas:

- supervision of market participants and enforcement of the Participant Rules;
- supervision of listed issuers and enforcement of the Listing Rules;
- allocation of human, technological and financial resources as it affects performance of the regulatory functions of NZX;
- internal practices and procedures associated with investigations, price enquiries, complaints-handling and referrals;
- discipline practices, procedures and resources;
- arrangements for market infrastructure development and maintenance;
- Special Division practices, procedures and resources;
- corporate governance arrangements, including board composition, policy setting, crisis response and oversight of executive management, with reference to regulatory standards relating to governance of demutualised exchanges under IOSCO and other international principles; and
- the impact, if any, of NZX's expanding commercial activities on its regulatory function.

APPENDIX 3: PROCESS

In conducting the review the Commission undertook:

- Discussions with senior NZX personnel and Board members, the chairman of NZMDT and the chairman of the Special Division;
- A review of :
 - A detailed report prepared by NZX covering topics that the Commission had foreshadowed for this assessment;
 - Information held in a cross-section of files of NZX;
 - Information received from and about NZX in the context of the oversight;
 - Information received from and about NZX in the context of the ordinary course of the Commission's dealings;
 - Information from external public sources, including media and industry commentary; and
 - The operation of the market throughout the Review Period.

The oversight review is conducted subject to privacy and confidentiality orders. These orders are intended to encourage free and frank discussion between the parties and to protect against disclosure of material to third parties for the duration of the oversight review.

