NEW ZEALAND MARKETS DISCIPLINARY TRIBUNAL

22 October 2014

ANNOUNCEMENT OF NZ MARKETS DISCIPLINARY TRIBUNAL

PUBLIC CENSURE OF KVB KUNLUN NEW ZEALAND LIMITED BY THE NZ MARKETS DISCIPLINARY TRIBUNAL FOR BREACHES OF NZX PARTICIPANT RULES 3.9, 3.13(c), 8.1.1(c), 8.4.1, 10.5.4, 10.5.9 and 10.5.10.

1. In a determination of the NZ Markets Disciplinary Tribunal (*Tribunal*) dated 8 October 2014, the Tribunal found that KVB Kunlun New Zealand Limited (*KVBA*), an NZX Advising Firm, breached NZX Participant Rules (*Rules*) 3.9, 3.13(c), 8.1.1(c), 8.4.1, 10.5.4, 10.5.9 and 10.5.10.

2. In a separate determination dated 8 October 2014, the Tribunal found that Mr Jimmy Koh, KVBA's Managing Principal from August 2011 until 4 April 2014, breached Rules 3.3.2 and 10.5.10. Mr Koh has also been publicly censured by the Tribunal.

Background

3. On 16 December 2013, NZX Regulation (*NZXR*) conducted a routine inspection of KVBA. During this inspection, NZXR observed that KVBA's Employees and Prescribed Persons had participated in the Z Energy IPO. KVBA had failed to provide NZX with the necessary certification before offering shares in the Z Energy IPO to its Employees and Prescribed Persons in breach of Rule 10.5.4.

4. NZXR also observed that over a seven month period from 10 May 2013 to 20 November 2013, there were 29 instances where KVBA's Employees and Prescribed Persons sold securities before the expiry of the mandatory 10 Business Day holding period required under Rule 10.5.9 (*Holding Period*).

5. In each case, Mr Koh (KVBA's then Managing Principal) had approved the sale of the relevant securities. NZX alleged that this approval was given by Mr Koh without first considering whether the requests were made because of special personal circumstances unrelated to market prices – as required under Rule 10.5.10.

6. On 21 May 2014, KVBA self-reported a further instance of the Holding Period requirement not being met on 19 December 2013 regarding the sale of securities by an employee. Mr Koh again gave approval, improperly concluding that there was sufficient evidence of special personal circumstances for the purposes of Rule 10.5.10.

7. Given the breaches of Rules 10.5.4, 10.5.9 and 10.5.10, NZX submitted that KVBA had also breached the requirements in Rules 3.9, 3.13(c), 8.1.1(c) and 8.4.1 to comply with the Rules, to observe Good Broking Practice and to ensure that its employees comply fully with the Rules and at all times observe Good Broking Practice.

Determination

8. The Tribunal found that KVBA breached Rules 10.5.4, 10.5.9 and 10.5.10 and, as a consequence, Rules 3.9, 3.13(c), 8.1.1(c) and 8.4.1.

9. KVBA acknowledged that the Rules had been breached and that it must take responsibility under the Rules for the conduct of its employees.

Penalty

10. In determining the appropriate penalty to impose the Tribunal considered the matters prescribed in Tribunal Rule 11.16.1, including the conduct of KVBA over the previous 24 month period, the severity of the matter, any benefit obtained or detriment suffered as a consequence of the breach, the reputational impact of the penalty being imposed and any other mitigating factors.

Conduct of KVBA

11. KVBA accepted that the breaches had occurred but in mitigation submitted that culpability lay with its personnel, particularly its former Managing Principal, Mr Koh.

12. KVBA submitted that it did have adequate internal systems and processes in place for an NZX Advising Firm, but that no system could prevent key personnel deliberately withholding compliance information and that there was no prior warning that the systems in place could be circumvented in the manner that occurred.

13. However, the Tribunal did not accept those submissions. The Tribunal considered that KVBA should have had better procedures in place to ensure that its compliance staff regularly reviewed any trading by personnel. The Tribunal also considered that KVBA's failure to have the appropriate structures and procedures in place allowed the Holding Period breaches to continue unchecked for such an extended period.

14. While there has been no suggestion that KVBA deliberately breached the Rules, the Tribunal is concerned that the conduct of its personnel, in particular its former Managing Principal Mr Koh, showed a complete disregard for compliance and, ultimately, KVBA is responsible for the actions of its employees.

15. The Tribunal notes that this is the first occasion a breach by KVBA has been referred to the Tribunal. The Tribunal also notes that KVBA has assured NZX that it has tightened its procedures and has placed more emphasis on compliance to ensure that no further breaches occur.

Severity of the breach

16. The Tribunal takes the breach of the Rules by KVBA very seriously. The Tribunal is concerned that these breaches, in particular the breach of Rule 10.5.9 (which is designed to prevent short-term trading by Employees and Prescribed Persons), carries with it the risk of undermining the fairness and reputation of NZX's markets. Such extensive breaches of this Rule on numerous occasions can only bring the market into disrepute.

17. The Tribunal also took into account:

    a. the number of offences and the fact that only the last of the breaches of the Holding Period were the subject of self-reporting, albeit some 5 months after the breach (and the breach itself occurred two days after some of the findings of the inspection had already been made known to KVBA staff);

b. the fact that most of the infringing trades were made immediately following allotment. This is not the hallmark of an innocent mistake and suggests that the shares were simply being acquired by Employees and Prescribed Persons in order to be stagged; and

c. the Tribunal's concerns that some of the material indicated that the offending was deliberate, was known to a number of KVBA staff and raised questions as to whether client interests were placed ahead of those of Employees and Prescribed Persons.

18. The Tribunal considers that the breaches fall within Penalty Band 5 of the Tribunal's Procedures, indicating that a penalty of up to $50,000 in the case of a non-individual is appropriate.

19. The Tribunal notes that it is incumbent on all Market Participants to foster a climate of adherence to the Rules. It is not enough to have systems in place – they must be seen to be effective and they must be continually checked to ensure that they are effective. It is clear to the Tribunal that KVBA failed in this regard.

Benefit obtained/detriment suffered

20. NZXR submitted that the Employees and Prescribed Persons of KVBA who traded within the Holding Period made gains which would not otherwise have been made had Mr Koh and KVBA complied with the Rules. If these trades had been made immediately upon expiry of the Holding Period, these individuals would have made, in aggregate, approximately $18,000 less than they otherwise did.

21. NZXR did not allege a loss to KVBA's clients as a result of the breaches. However, the Tribunal was not presented with evidence to enable it to make a conclusion on this point.

Reputational impact

22. The Tribunal notes that any public censure of a Market Participant is likely to be detrimental to its market reputation. The Tribunal takes its responsibilities very seriously and is very mindful of the reputational consequences of a public censure in which a Market Participant is named.

23. However, the principles in the Tribunal's September 2007 policy on publicly naming a Market Participant found to have breached the Rules are clear:

a. the disciplinary process should be transparent; and

b. it is likely that the participant's name will be published when public confidence in the sector has been damaged, the participant has been involved in repeat offences and shown disregard for the Rules and/or the penalty for the participant falls within Penalty Bands 4 to 8 of the Tribunal's Procedures.

24. In this case, the breaches (particularly regarding the Holding Period) have the potential to damage public confidence in the market, KVBA has been involved in repeated offences and the extent and nature of the offending indicates a disregard for the Rules,

and the Tribunal considers that the breaches fall within Penalty Band 5 of the Tribunal's Procedures.

Mitigating Factors

25. The Tribunal considered several mitigating factors in this case, including that KVBA had acknowledged that the breaches had occurred, investigated what occurred during the tenure of its former Managing Principal, self-reported the additional breach discovered as part of that investigation and implemented greater levels of compliance monitoring and reporting.

Penalties

26. The Tribunal imposes the following penalties on KVBA:

    a. This public censure will be made;

    b. KVBA will pay to the NZX Discipline Fund $40,000 by way of penalty in respect of the breaches of Rules 10.5.4, 10.5.9 and 10.5.10;

    c. KVBA will pay the costs of the Tribunal in considering this matter; and

    d. KVBA will contribute towards the actual costs and expenses incurred by NZX in relation to this matter.

Censure

27. The Tribunal hereby publicly censures KVBA for its breach of Rules 10.5.4, 10.5.9 and 10.5.10. In addition, the Tribunal notes that these breaches amount to conduct that failed to comply fully with all applicable Rules, and at all times observe good broking practice, in breach of Rules 3.9, 3.13(c), 8.1.1(c) and 8.4.1.

The Tribunal

28. The Tribunal is a disciplinary body independent of NZX and its subsidiaries. The Financial Markets Authority approves its members. Under the Tribunal Rules, the Tribunal determines and imposes penalties for referrals made to it by NZX in relation to the conduct of parties regulated by the market rules.