

ANNUAL REPORT 2016

NEW ZEALAND MARKETS DISCIPLINARY TRIBUNAL



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CHAIRMAN'S REPORT

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FUNCTION OF NZ MARKETS DISCIPLINARY TRIBUNAL

The NZ Markets Disciplinary Tribunal (*Tribunal*) is an independent regulatory body established under the NZ Markets Disciplinary Tribunal Rules (*Tribunal Rules*). The Tribunal serves in an adjudicative role. It is not an inspectorate of market conduct. That role is performed by NZX Regulation.

The Tribunal's principal role is to determine whether there has been a breach of the NZX Conduct Rules¹, the NZX Derivatives Market Rules, the Clearing and Settlement Rules of New Zealand Clearing Limited and the Fonterra Shareholders' Market Rules (together the *Market Rules*) in matters referred to it by NZX Limited (NZX).

RELATIONSHIP WITH NZX

The Tribunal is funded by NZX and members of the Tribunal are appointed by NZX (subject to confirmation by the Financial Markets Authority). Apart from that, the Tribunal is wholly independent of NZX.

As I have noted previously, the Tribunal's working relationship with NZX is good. Regular meetings continue to take place between the Chair and Executive Counsel of the Tribunal with NZX Regulation and the Head of Market Supervision, both on policy matters and operational issues.

REFERRALS

The number of referrals from NZX to the Tribunal reduced significantly from 13 in 2015 to four in 2016. Three referrals involved market participants and one involved an issuer. Three of the referrals involved settlements. The other referral also involved an appeal from the issuer of the Tribunal's decision. The appeal division denied the appeal and confirmed the original decision of the Tribunal.

The reduction in referrals resulted primarily from the adoption of new Tribunal Rules and Procedures in February 2016, which made provision for a new Infringement Notice regime whereby NZX Regulation is able to issue fines for minor breaches. Many of the Tribunal's referrals in previous years could now be dealt with by the new regime – with consequent savings for respondents. Respondents have the right to appeal the Infringement Notice to the Tribunal but this right has not yet been exercised.

Whilst the new penalties guidelines provide a simpler regime with three penalty bands, the Tribunal has stated that penalties for repeat offenders and/or serious breaches are likely to continue to increase.

NZX REPORT TO THE TRIBUNAL

NZX Regulation has recently published its NZX Oversight & Engagement Report 2017, the first in an annual series intended to provide insight into its investigation, monitoring and enforcement work, and its engagement with issuers and participants. The report includes information on NZX Regulation's investigation and enforcement activity undertaken during 2016 and was provided to the Tribunal in connection with NZX's annual regulatory reporting requirements under the Tribunal Rules. The report can be found here www.nzx.com/regulation/publications.

¹ The NZX Conduct Rules comprise 1) the NZX Participant Rules, which govern the conduct of market participants in NZX's markets – the Main Board, Debt Market, NZAX Market and the NXT Market; and 2) the NZX Listing Rules governing the conduct of issuers whose securities are listed on NZX's markets.

MEMBERS

The Tribunal has members appointed to represent issuers, markets participants, clearing participants, derivatives participants and the public, as well as a legal category. In June 2017, the Tribunal has a number of members retiring at the end of their third terms of appointment (each term being three years), including the Deputy Chair Shane Edmond, the Special Division Chair Andrew Beck, and myself. In addition, Mark Freeman, Don Holborow and David Boldt will be retiring. I would like to acknowledge and thank each of the retiring members for their significant contributions to the Tribunal over the last nine years.

Richard Bodman was appointed to the Special Division during 2016 but has recently resigned from the Tribunal upon his appointment to the Board of NZX. David Kreider has also recently resigned from the Tribunal. I thank Richard and David for their contributions to the Tribunal.

As announced, five new members have recently been appointed to the Tribunal – Matthew Blackwell, Deemple Budhia, Rachel Dunne, Ivana Erceg Flerchinger and Simon Vodanovich.

SPECIAL DIVISION

Tribunal Rule 3.2 establishes a Special Division which is tasked with administering the NZX Conduct Rules as they apply to NZX as a listed issuer and any of its related entities. I would again like to acknowledge the contributions of Andrew Beck as Chair of the Special Division and the other members of the Special Division as their work load has been significant throughout 2016.

RESOURCING

As required by the Tribunal Rules, the Tribunal confirms that it believes it has adequate resources available to it to undertake its role under the Tribunal Rules, and that NZX has continued to provide all the assistance which the Tribunal requires to undertake its role.

DISCIPLINARY FUND

The NZX Discipline Fund accounts indicate that there is an accumulated surplus of \$543,724 as at 31 December 2016. The Tribunal is pleased to see that proceeds of the Discipline Fund have been well utilised during 2016 in providing seminars and education opportunities to the market and funds for the purposes of the Participant Rules review. It is anticipated that funds will continue to be used in 2017 on further market education and engagement with issuers and participants.

As I sign off my final report as Chair of the Tribunal, I would like to acknowledge the Tribunal's executive counsel Rachel Batters for her outstanding guidance, counsel and dedication to the Tribunal.



David Flacks | CHAIRMAN
3 April 2017

MEMBERS

MEMBERS

MEMBERS OF THE TRIBUNAL AS AT 31 DECEMBER 2016

LEGAL

David Flacks (Chairman), Andrew Beck, David Boldt, Mark Freeman, Don Holborow and Rachael Reed.

LISTED ISSUER

Jo Appleyard, Kevin Baker, Trevor Janes, James Ogden, Dame Alison Paterson, Susan Peterson and Christopher Swasbrook.

MARKET PARTICIPANTS

Shane Edmond (Deputy Chairman), Geoff Brown and Nick Hegan.

MEMBERS OF THE PUBLIC

Richard Bodman*, Danny Chan, Richard Keys, David Kreider*, Richard Leggat, Noeline Munro, Mariëtte van Ryn and Leonard Ward.

CLEARING PARTICIPANTS

Richard Bodman* and Geoff Brown

DERIVATIVES PARTICIPANTS

Richard Bodman*

MEMBERS OF THE SPECIAL DIVISION AS AT 31 DECEMBER 2016

Andrew Beck (Chairman), Kevin Baker, Shane Edmond, James Ogden and Richard Bodman*.

Rachel Batters and Stephen Layburn act as Executive Counsel to the Tribunal.

* Richard Bodman and David Kreider resigned from the Tribunal in March 2017.

STATEMENTS OF CASE, FINDINGS AND PENALTIES

NZMDT 1/2016 NZX V MACQUARIE SECURITIES (NZ) LIMITED (MAQA)

Division: Mark Freeman (division chair), Nick Hegan and Noeline Munro

Statement of Case served: 1 February 2016

Date of Determination: 23 February 2016

Rule Breached: NZX Participant Rules 4.5.2, 8.8.1, 10.6.1(b) and 10.8.1

FACTS:

Under the NZX Participant Rules, Trading Participants must ensure the accuracy of the details, the integrity and bona fides of all trading messages which are entered into the Trading System, that its conduct promotes and helps maintain an orderly market and that the use and access by each Direct Market Access (DMA) Authorised Person and Dealer does not interfere with the efficiency and integrity of the markets operated by NZX.

On 5 November 2015, a DMA client of MAQA (*the Client*) entered 220 orders to buy a total of 125,000 Westpac Banking Corporation ordinary shares (*WBC shares*), made 39 amendments to these orders and either completely or partially deleted 81 of these orders. As a consequence of these orders, 196 trades were completed within the relevant trading window, which significantly exceeded the average number of trades in WBC shares during that period. The trades also resulted in an intraday price increase of more than 19%.

MAQA advised that the Client had intended to trade WBC shares on the ASX but had incorrectly selected trading on the NZX Main Board when entering the order. Due to the lower liquidity in WBC shares on the NZX Main Board, and an error in information sourced from the Client's market data provider, the Client's algorithm did not operate as expected.

As the trades occurred in error and had a market impact, NZX Surveillance exercised its discretion under Participant Rule 10.15.5 and cancelled 188 trades.

TRIBUNAL FINDINGS:

The Tribunal approved a settlement agreement between NZX and MAQA under which MAQA accepted breaching the Participant Rules.

The Tribunal noted that ensuring the accuracy of trades is paramount to maintaining an orderly market. Accordingly, all Trading Participants are responsible under the Participant Rules for ensuring the accuracy of orders entered into the trading system regardless of whether they are entered by the Participant itself or by a DMA client. Trading Participants must also ensure that they have adequate systems in place, including appropriate filters, so that if an order error is made, it can be promptly detected and prevented.

The Tribunal considered the breach in this case to be particularly serious. Although the Tribunal accepted that the breach was caused by the Client's unintended error, the trades had a significant impact on the market and other Participants. However, in approving the settlement agreement, the Tribunal considered mitigating factors, including that MAQA immediately made changes to its filters to prevent a recurrence of this issue and that the breach arose due to the Client's error.

PENALTY:

MAQA was ordered to pay \$40,000 to the NZX Discipline Fund and was publicly censured.

COSTS:

MAQA was ordered to pay the costs of the Tribunal and NZX.

PUBLICATION:

The Tribunal released its censure of MAQA - <https://nzx.com/NZMDT/tribunal-decisions#2016>.

NZMDT 2/2016 NZX V MARKET PARTICIPANT A

Division: Mark Freeman (division chair), Geoff Brown and Mariëtte van Ryn

Settlement Agreement filed 16 May 2016

Date of Determination: 14 June 2016

Rule Breached: NZX Participant Rules 8.8.1 and 10.2.2

FACTS:

A DMA client of Market Participant A entered sell orders for the securities of two NZX Main Board Issuers into the Trading System. The orders triggered Market Participant A's filters and were subsequently placed in the DMA filter queue of a Dealer for assessment. The relevant Dealer entered the sell orders without first considering the possible market impact of those orders. The orders moved the respective securities' prices down by 10.34% and 10% following market open.

TRIBUNAL FINDINGS:

The Tribunal approved a settlement agreement between NZX and Market Participant A under which Market Participant A accepted breaching the Participant Rules.

The Tribunal noted that the breach in this instance occurred because the Dealer involved ignored procedure, due to time pressures, and did not individually review the orders stopped by the DMA filters before putting them to market. While the fact that Market Participant A did have adequate filters and procedures in place to prevent such a breach was a significant mitigating factor in this case, the Tribunal noted that Participants must ensure that their Dealers follow procedures.

PENALTY:

Market Participant A was ordered to pay \$20,000 to the NZX Discipline Fund.

COSTS:

Market Participant A was ordered to pay the costs of the Tribunal and NZX.

PUBLICATION:

Market Participant A was privately censured by the Tribunal. In coming to its decision to approve the private censure of Market Participant A under the settlement agreement, the Tribunal considered the matters set out in Tribunal Procedure 9.3. In particular, that the Tribunal must use its discretion in imposing a penalty of public censure and must have regard to the overall conduct of a respondent.

The Tribunal noted that after taking into account the mitigating circumstances, in particular Market Participant A's good compliance history, that appropriate processes and filters were in place and that the breach did not reflect a systemic problem, but rather a lack of judgement by the Dealer involved, the Tribunal considered that a private censure in this instance was appropriate.

NZMDT 3/2016 NZX V PYNE GOULD CORPORATION LIMITED (PGC)

Division: Susan Peterson (division chair), Christopher Swasbrook and Leonard Ward

Statement of Case served: 17 August 2016

Date of Determination: 27 September 2016

Rule Breached: NZX Main Board Rules 3.3.1(c), 3.6.2(b), 3.6.2(c), 10.3.1(b), 10.4.1 and 10.4.2

FACTS:

PGC breached NZX Main Board Listing Rule 10.4.1 by failing to provide its annual report for the year ended 30 June 2015 by 30 September 2015. The duration of the breach was 159 business days.

PGC breached NZX Main Board Listing Rule 10.3.1(b) by failing to provide its preliminary announcement for the six months ended 31 December 2015 by 29 February 2016. The duration of the breach was 70 business days.

PGC breached NZX Main Board Listing Rule 10.4.2 by failing to provide its half year report for the six months ended 31 December 2015 by 31 March 2016. The duration of the breach was 49 business days.

PGC breached NZX Main Board Listing Rules 3.3.1(c), 3.6.2(b) and 3.6.2(c) following the resignation of an Independent Director on 29 October 2015. A new Independent Director was appointed on 23 May 2016. PGC was in breach of these Rules for 138 business days.

TRIBUNAL FINDINGS:

The Tribunal noted several factors in this case which were likely to increase the penalty in respect of PGC's breaches of the periodic reporting requirements, including that:

- a. The breaches occurred over a significant period of time. PGC's breach of Rule 10.4.1 was the longest period a breach of a reporting requirement has occurred in any matter previously referred to the Tribunal.
- b. The breaches form a pattern of poor compliance history. This was PGC's fourth referral to the Tribunal, the most referrals of any Issuer.
- c. The breach of the reporting requirements is a recurring one. PGC also breached Rule 10.4.1 for failing to release its 2014 annual report when due.

In respect of the breaches of the corporate governance requirements, the Tribunal noted that directors, for various reasons, may resign without warning. While the process for replacing a director must be robust, such appointments must be made promptly. If an Issuer has only the minimum number of Independent Directors, it is imperative that it has a succession plan in place should one of these members resign. The Tribunal also noted that PGC had previously breached the corporate governance requirements.

The Tribunal noted that it had repeatedly advised the market of its intention to increase the penalties imposed on Issuers for breaches of the periodic reporting requirements. The Tribunal also noted that it had advised the market of its intention to increase penalties involving repeat offenders.

PENALTY:

PGC was ordered to pay \$275,000 to the NZX Discipline Fund and was publicly censured for its breaches of NZX Main Board Listing Rules 10.3.1(b), 10.4.1 and 10.4.2.

PGC was ordered to pay \$25,000 to the NZX Discipline Fund and was publicly censured for its breaches of NZX Main Board Listing Rules 3.3.1(c), 3.6.2(b) and 3.6.2(c).

COSTS:

PGC was ordered to pay the costs of the Tribunal and NZX.

PUBLICATION:

The Tribunal released its determination and censures of PGC - nzx.com/NZMDT/tribunal-decisions#2016.

NZMDT 4/2016 APPEAL FROM NZMDT 3/2016 NZX V PGC

Division: Rachael Reed (appeal division chair), Nick Hegan and Dame Alison Paterson

Statement of Appeal filed: 7 October 2016

Date of Determination: 27 October 2016

BACKGROUND:

On 27 September 2016, the Tribunal made a determination in the matter NZMDT 3/2016 NZX v PGC. In the determination, the Tribunal found that:

1. PGC had breached NZX Main Board Rules 10.3.1(b), 10.4.1 and 10.4.2 (*Periodic Reporting Breaches*) and ordered that PGC be publicly censured, pay a financial penalty of \$275,000 and pay the costs and expenses of the Tribunal and NZX in considering the matter; and
2. PGC had breached NZX Main Board Rules 3.3.1(c), 3.6.2(b) and 3.6.2(c) (*Corporate Governance Breaches*) and ordered that PGC be publicly censured, pay a financial penalty of \$25,000 and pay the costs and expenses of the Tribunal and NZX in considering the matter.

On 7 October 2016, PGC filed a statement of appeal. PGC did not dispute the findings of breach. However, PGC appealed part of the determination, in particular, the Tribunal's decision to impose a penalty of \$275,000 for the Periodic Reporting Breaches. PGC sought a variation of that penalty to between \$70,000 and \$80,000. PGC did not seek a variation to the penalty imposed by the Tribunal for the Corporate Governance Breaches.

TRIBUNAL FINDINGS:

The Appeal Division reviewed the findings of the Tribunal and concluded that the Tribunal did not err in exercising its discretion when determining the penalty imposed for the Periodic Reporting Breaches. In this regard, the Tribunal did not act on the wrong principle or misapply the relevant Rules, it did not fail to take into account a relevant matter, nor did it take into account an irrelevant matter. The Appeal Division did not identify any procedural unfairness or irregularity.

The Appeal Division agreed with the Tribunal that the offending was serious and aggravated by PGC's previous and recent history of breaching the periodic reporting rules. Given the aggravating and mitigating features the Appeal Division considered that the Periodic Reporting Breaches warranted a penalty in the mid to upper part of penalty band 3 of the Tribunal Procedures. The Appeal Division also considered that, when the penalty for both the Periodic Reporting Breaches and the Corporate Governance Breaches were considered in totality, the overall penalty imposed by the Tribunal was within the available range for this type of serious offending.

In accordance with Tribunal Rule 7.4.1, the Appeal Division affirmed the determination of the Tribunal in the matter NZMDT 3/2016 NZX v PGC.

COSTS:

The Appeal Division ordered PGC to pay the costs of the Appeal Division and NZX in considering the appeal.

PUBLICATION:

The Appeal Division released its decision - nzx.com/NZMDT/tribunal-decisions#2016.

NZMDT 5/2016 NZX V CLEARING PARTICIPANT A

Division: Shane Edmond (division chair), Jo Appleyard and Richard Leggat

Settlement Agreement filed: 1 December 2016

Date of Determination: 8 December 2016

Rule Breached: Clearing and Settlement Rule 4.2.3

FACTS:

On three occasions in 2016, Clearing Participant A failed to meet its settlement obligations with New Zealand Clearing Limited (CHO) as required under the Clearing and Settlement Rules. While each occasion constituted a Credit Event, because Clearing Participant A held sufficient funds in aggregate across all of its accounts, CHO determined not to treat the Credit Events as Declared Defaults.

NZX Regulation advised the Tribunal that Clearing Participant A had previously breached these Rules in similar circumstances.

TRIBUNAL FINDINGS:

The Tribunal approved a settlement agreement between NZX and Clearing Participant A under which Clearing Participant A accepted breaching the Clearing and Settlement Rules.

The Tribunal noted its concern that Clearing Participant A had repeatedly breached the Rules and that its failure to adequately remedy deficiencies in its processes was a particularly aggravating factor in this case.

However, in coming to its decision to approve the settlement agreement, the Tribunal considered as mitigating factors that (a) the breaches were of a minor nature and did not arise due to liquidity issues with Clearing Participant A holding sufficient aggregate cash amounts in its accounts to cover its obligations; (b) Clearing Participant A had subsequently taken a number of steps to remedy its processes and systems to ensure greater oversight of the settlement process; and (c) the breaches did not create any market impact nor did Clearing Participant A derive any benefit from them or its clients' any losses.

PENALTY:

Clearing Participant A was ordered to pay \$20,000 to the NZX Discipline Fund.

COSTS:

Clearing Participant A was ordered to pay the costs of the Tribunal and NZX.

PUBLICATION:

Clearing Participant A was privately censured by the Tribunal. In coming to its decision to approve the private censure of Clearing Participant A under the settlement agreement, the Tribunal considered the matters set out in Tribunal Procedure 9.3. In particular, that the Tribunal must use its discretion in imposing a penalty of public censure and must have regard to the overall conduct of a respondent.

While Clearing Participant A had been involved in repeated breaches, the Tribunal considered that having regard to the mitigating factors, the likely detrimental consequences of publicly naming Clearing Participant A were too severe given the minor nature of the breaches involved. The Tribunal noted, however, that should Clearing Participant A be found in breach of these Rules again, it was unlikely that the Tribunal would take the same approach.

REPORT ON SPECIAL DIVISION ACTIVITIES

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The Special Division of the Tribunal exists to foster market confidence and to determine that the Market Rules are applied to NZX or a Related Entity in an impartial and independent manner.

The Special Division had a reasonably busy year with the funds managed by Smartshares Limited transitioning to the Financial Markets Conduct Act 2013. This involved the Special Division reviewing and approving various Product Disclosure Statements and granting various waivers from the NZX Main Board Listing Rules. Copies of the Special Division's waiver decisions can be viewed at <https://nzx.com/NZMDT/special-division>.

As with previous years, the Special Division also considered a number of SMARTS alerts referred to it by NZX Surveillance. A summary of each referral to the Special Division in 2016 follows this report.

Richard Bodman was appointed to the Special Division during 2016 but has since resigned upon his appointment to the NZX Board.

I thank all the Special Division members for their work this year.



Andrew Beck | SPECIAL DIVISION CHAIRMAN
3 April 2017

NZMDT SPECIAL DIVISION MATTERS – 1 JANUARY TO 31 DECEMBER 2016

During 2016, the Special Division received 19 referrals from NZX Surveillance as outlined below.

DATE REFERRED IN 2016	ISSUER	ACTION
8 January	USF, APA, EUF, ASP, NPF	Considered the nature of the alert and determined that no further investigation was necessary.
27 January	NZX	Considered the nature of the alert and determined that no further investigation was necessary.
14 March	NZX	Considered the nature of the alert, sought information from the market participant involved and determined that no further action was necessary.
1 April	NZX	Considered the nature of the alert and determined that no further investigation was necessary.
26 April	ASF	Considered the nature of the alert, sought information from the market participant involved and from Smartshares Limited, and determined that no further investigation was necessary.
17 June	USF	Considered the nature of the alert, sought information from the market participant involved and determined that no further action was necessary.
7 July	EUF, APA, USF	Considered the nature of the alert and determined that no further investigation was necessary.
11 July	NZX	Considered the nature of the alert and determined that no further investigation was necessary.
2 August	EMF	Considered the nature of the alert and determined that no further investigation was necessary.
8 August	NZX	Considered information provided by NZX Surveillance regarding a media article, sought further information from NZX and determined that no further action was necessary.
31 August	NZX	Considered the nature of the alert and determined that no further investigation was necessary.
6 September	NZX	Considered the nature of the alert and determined that no further investigation was necessary.
12 September	NZX	Considered the nature of the alert and determined that no further investigation was necessary.
15 September	EUF	Considered the nature of the alert, sought information from the market participant involved and determined that no further action was necessary.
28 September	EUF, APA	Considered the nature of the alert, sought information from the market participant involved and determined that no further action was necessary.
5 October	NZX	Considered information provided by NZX Surveillance regarding an announcement made by NZX and determined that no further action was necessary.
3 November	DIV	Considered the nature of the alert and determined that no further investigation was necessary.
3 November	NZX	Considered the nature of the alert, sought information from the market participant involved and determined that no further action was necessary.
16 November	EUF	Considered the nature of the alert, sought information from NZX Surveillance and the market participant involved and determined that no further action was necessary.

DIRECTORY

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DAVID FLACKS | CHAIRMAN

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