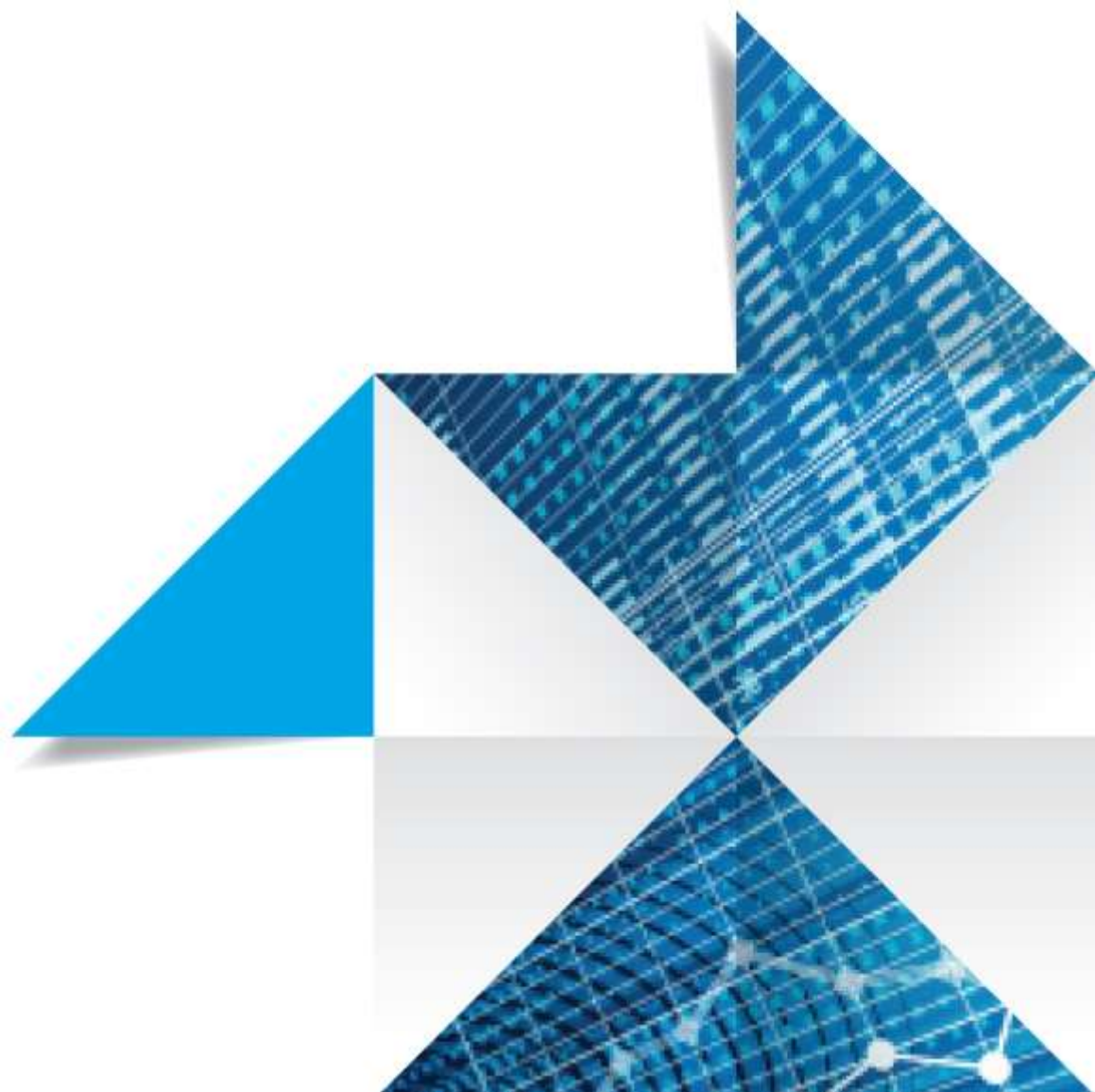




# Consultation Paper

S&P/NZX 20 Futures Relaunch:  
Amendments to Regulatory Settings

July 2024



# Contents

Introduction.....	3
Background .....	3
Consultation Process.....	4
NZX 20 Futures Product Settings .....	5
Final Settlement Price .....	5
Trading Timetable.....	5
Multiplier reduction .....	5
Block Trade thresholds.....	5
Contract series .....	5
Emergency powers.....	5
NZX 20 Futures Trade Settings .....	6
Block Trades and EFP/EFS.....	6
Roll Business.....	6
Wash Trades .....	7
Error Trades .....	7
NZX 20 Futures Reporting and Clearing Settings .....	8
Compliance reporting attestation periods.....	8
Position Reporting .....	8
Eligible Collateral.....	9
Valuation/Haircuts .....	9
Set-Off... ..	10

This Consultation Paper has been prepared by NZX to seek comment on the proposals contained in the paper, with a view to ensuring that the proposals will enable NZX to operate its markets on a fair, orderly and transparent basis. The proposals set out in this paper do not reflect NZX's concluded views of the matters raised. Capitalised terms which are not defined in this Consultation Paper have the same meanings given to them in the relevant Rule set.



# Introduction

## Background

Since 2020, NZX has been looking to refresh the S&P/NZX 20 Index Futures Contract (**NZX 20 Futures**). The refresh aligns with the vision of sustainable market development outlined in the Growing New Zealand's Capital Markets 2029 Report<sup>1</sup>, and will help drive growth in New Zealand's capital markets by expanding the suite of financial products offered by NZX.

Following two years of internal review, and extensive engagement with over 45 external stakeholders, NZX now wishes to consult with the market in relation to changes to its regulatory settings to relaunch NZX 20 Futures.

NZX is proposing various amendments to the following regulatory documents, which are attached as exposure drafts to this Consultation Paper:

- NZX 20 Futures Contract Specification (**Contract Specification**)
- NZX 20 Futures Contract Terms and Administrative Procedures (**CTAP**)
- NZX Derivatives Market Rules (**Derivatives Rules**)
- NZX Derivatives Procedures (**Derivatives Procedures**)
- NZX Participant Rules (**Participant Rules**)
- NZX Trading Conduct Guidance Note (**Guidance Note**)
- New Zealand Clearing Limited Clearing & Settlement Rules (**C&S Rules**)
- New Zealand Clearing Limited Clearing and Settlement Procedures (**C&S Procedures**)
- New Zealand Depository Limited Depository Operating Procedures (**D Procedures**)

The proposed amendments either reflect changes to the product design, or support broader participation in relation to the trading and clearing of NZX 20 Futures.

NZX considers that these changes will promote innovation and flexibility in NZX's markets, by encouraging confident and informed participation by investors and Participants. These changes will continue to enable NZX to operate its markets on a fair, orderly, and transparent basis, consistent with NZX's obligations under the Financial Markets Conduct Act 2013.

### Consultation on market maker settings

NZX is also conducting a review into its market making settings to ensure they are correctly calibrated under the Participant and Derivatives Rules, including in respect of the accreditation and ongoing requirements that apply to Designated Market Makers.

The market making consultation is being run alongside this review, and the materials relating to that review including a consultation paper, and exposure draft of proposed changes to the Participant Rules and Derivatives Rules is available to view [on NZX's Consultation page](#).

The closing date for submissions in relation to the market maker settings consultation is 19 July 2024.

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<sup>1</sup> [Growing New Zealand's Capital Markets 2029](#)

## Consultation Process

We invite interested parties to provide their views on the proposals contained in this paper by emailing a written submission to [policy@nzx.com](mailto:policy@nzx.com).

Alternatively, if you would prefer to provide a verbal submission, please email NZX Policy to arrange a time to speak with us.

You can contact NZX Policy at: [policy@nzx.com](mailto:policy@nzx.com)

The closing date for submissions is 19 August 2024.

NZX may publish the submissions it receives, so please clearly indicate if you do not wish for your submission to be published, or if part of your submission contains confidential information. If you have any queries in relation to this consultation document, please contact:

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## NZX 20 Futures Product Settings

NZX is proposing a number of changes to the Contract Specification and CTAP that reflect the change in features of the NZX 20 Futures product, in line with the feedback received from key stakeholders through the product design phase. These proposed changes are described below.

### Final Settlement Price

NZX is proposing to amend the Final Settlement Price for the NZX 20 Futures, so that the contract settles to the closing price of the S&P/NZX 20 Capital Index value calculated by S&P, using the close prices on the Last Trading Day in accordance with the S&P/NZX New Zealand Indices Methodology. This differs from the current Final Settlement Price which uses a special opening quotation value of the S&P/NZX 20 Capital Index.

### Trading Timetable

NZX is proposing that the Last Trading Day for the NZX 20 Futures product will cease at 5:15pm NZST/NZDT on the third Thursday of the Contract Month (unless that day is not a Trading Day, in which case the Expiry Calendar will state that the next Trading Day will be the Last Trading Day).

The Provisional Final Settlement Price and Final Settlement Price will be notified to the market on the Trading Day after the Last Trading Day (usually the third Friday of the Contract Month) with the Settlement Date being the second Trading Day after the Last Trading Day of the NZX 20 Futures (usually occurring on the following Monday).

NZX intends to publish an expiry calendar for the product in due course.

### Multiplier reduction

We are proposing to reduce the unit of trading for the NZX 20 Futures from \$25 to \$1 to enable a multiplier reduction, enabling smaller individual trades.

### Block Trade thresholds

We are also proposing to amend the NZX Derivatives Procedures to lift the Block Trade Threshold from 50 lots to 1,250 lots. Given the multiplier reduction, this keeps the notional value of the threshold the same.

The combination of Block Trade and Cross Transaction availability enables large size Orders to be executed without risk of interception, and enables Participants to actively negotiate flow as liquidity is developing.

### Contract series

We are proposing to amend the timing of the contract series for the NZX 20 Futures so that the contract delivery month is March, June, September and December, up to six calendar quarters ahead.

### Emergency powers

NZX is proposing to clarify the circumstances in which it would exercise its powers to determine an alternative Trading Day to be the Last Trading Day for the contract, or to use an alternative method for or timing of the calculation of the Provisional Final Settlement Price, and Final Settlement Price, which is an existing feature of the CTAPs.



The situations in which NZX would look to exercise its emergency powers include where NZX becomes aware that the NZX Derivatives Market would not be open on the Last Trading Day set out in the Expiry Calendar, or where NZX becomes aware that there is a significant error in the index value provided by S&P or in the prices established in the Close on the NZX Main Board. NZX does not intend to recalculate the value of the S&P/NZX 20 Capital Index itself, but intends to publish a procedure outlining the alternative values that it is likely to adopt in an emergency scenario.

NZX intends that the Provisional Final Settlement Price would be announced to the market by 5pm on the Trading Day after the Last Trading Day (normally Friday) in the event an emergency arose.

In addition, NZX retains a general discretion to amend the method for or timing of the calculation of the Provisional Final Settlement Price, and Final Settlement Price.

### **Position Limits**

Derivatives Rule 8.2 allows NZX to impose position limits on individual contracts. NZX has determined not to impose any position limits on the NZX 20 Futures Contract, but may do so in future.

## **NZX 20 Futures Trade Settings**

In addition to the proposed amendments to the NZX 20 Futures contract, NZX is proposing to make changes to the Derivatives Procedures and Trading Conduct Guidance Note to support and provide clarity to Participants as to the manner in which the product may be traded.

### **Block Trades and EFP/EFS**

We are proposing clarifying amendments to the Derivatives Procedures in relation to the manner in which Block Trades and Exchange for Physicals/Exchange for Swaps may be executed. Block Trades and EFPs will both be available for the NZX 20 Futures contract.

In particular we are proposing to amend the requirements for the manner in which these types of facilities are submitted to NZ RegCo Surveillance for acceptance, to require that the request to use these facilities is submitted electronically via the Trading System.

### **Roll Business**

NZX is aware that Participants may wish to Trade out of a position in the nearest delivery month and Trade into an equivalent position in a later delivery month (**Roll Business**) through the use of a Block Trade facility.

The ASIC Market Integrity Rules<sup>2</sup> expressly prohibit Roll Business from being conducted via a Block Trade. This prohibition enhances on-market liquidity and provides end clients and Participants with a greater ability to transact with Roll Business activity.

However, Participants undertaking Roll Business may benefit from the flexibility and efficiencies created by being able to utilise a Block Trading facility in these circumstances, noting that the

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<sup>2</sup> [ASIC Market Integrity Rules \(Futures Markets\) 2017, Rule 3.4.2](#)

Derivatives Procedures only allow Block Trading to occur in specific circumstances (for Orders of 1,250 Lots and if accepted by NZ RegCo Surveillance).

We are interested in submitters' views as to whether NZX should allow Roll Business to be effected through the Block Trade Facility.

### **Wash Trades**

We are proposing drafting amendments to align the requirements relating to Trades that result in no change in beneficial ownership under Derivatives Rule 8.7.11, with the requirements of the Participant Rules, to better reflect that the obligation relates to having appropriate systems and controls in place to prevent Orders being entered into the Trading System that result in Trades where there is no resulting change in Beneficial Ownership.

We are also proposing an amendment to the Trading Conduct Guidance Note to provide additional guidance in relation to an example of an additional circumstance where NZX's policy is not to take action where a legitimate transaction occurs, despite it not resulting in a change in beneficial ownership. NZX expects that regardless of its intended no-action approach, that Participants will actively monitor their trading behaviour, to ensure that a wash trade in the circumstances specified in the new example remains "accidental" in nature. NZX Participants should report such trades to NZ RegCo, and request that the trade be cancelled where possible.

The situation is where an "accidental" Trade arises in the NZX 20 Futures from the implied Order functionality when a Participant uses calendar spreads. NZX considers that it is helpful for Participants who wish to undertake calendar spread strategies to be provided with clarity around the application of NZX's wash trade requirements.

Implied Orders are generated by the Trading System through the calendar spread trading functionality and are not Orders that are directly entered into the Trading System by a Participant, these Orders should not give rise to concerns around the extent of active trading, or supply and demand in the NZX 20 Futures Contract. NZX also considers that the S&P/ NZX 20 Index value acts as an objective benchmark for Trades in the NZX 20 Futures Contract that reduces the risk that a wash trade will give rise to concerns relating to the value of the NZX 20 Futures Contract. We also expect the calendar spread functionality will primarily be utilised in the last two weeks prior to the expiry of a NZX 20 Futures Contract.

The additional example relates to circumstances where the wash trade is accidental, and as noted above, NZX expects such trades to be reported to NZ RegCo. NZ RegCo would consider taking enforcement action in the situation where a Participant was frequently reporting such Trades, as this may indicate that the Participant did not have appropriate visibility or control over its order book.

### **Error Trades**

In order to ensure that NZX can take appropriate action in relation to Error Trades, we are proposing amendments to Rule 8.8.4 so that NZX's powers are better aligned to enable it to amend as well as cancel Trades consistent with the powers NZX has in relation to the cash markets (as set out in Participant Rule 10.14.5).



## Consultation Questions – Trading the NZX 20 Futures Contract

1. Do you consider that NZX should expressly prohibit Roll Business from being undertaken in the NZX 20 Futures contract?
2. Do you have any comments in relation to the proposed changes to the Trading Conduct Guidance Note in relation to wash trades?

## NZX 20 Futures Reporting and Clearing Settings

### Compliance reporting attestation periods

NZX considers it is appropriate to reduce the attestation periods in relation to the general compliance attestations under the Participant, Derivatives, C&S and D Procedures from monthly to quarterly.

We consider that a quarterly rather than monthly compliance confirmation will reduce the compliance reporting burden on Participants, noting that Participants remain under standing obligations to comply with their obligations under the Rules at all times.

We are not proposing to amend the timing requirement for monthly capital adequacy reporting attestations, other than to streamline the reporting timeframes so that attestations are required to be provided within 10 business days after the last day of each reporting period. This will better standardise the obligations under the Rule sets. For example: for a reporting period ending on 30 June 2024, an attestation would be required on or prior to the close of business on Friday 12 July 2024.

In relation to annual compliance reporting requirements, we are proposing to align the requirements to those established by the current Participant and Derivatives Rules so that annual compliance reporting for Depository and Clearing Participants will now be due within 90 (rather than 10) business days after the end of each financial year.

We intend to update the Participant Portal to ensure reminder dates are appropriately calibrated, and to publish a calendar setting out reporting dates to assist Participants in understanding the revised reporting timeframes.

We are interested in broader feedback from Participants as to whether any changes should be made to the content of the compliance confirmation attestations, as we may review these requirements in more detail in future.

An exposure draft containing excerpts of the attestation requirements accompanies this Consultation Paper, for ease of reference.

### Position Reporting

NZX is proposing amendments to the Derivatives Rules and Procedures, and New Zealand Clearing Limited (**CHO**) is proposing amendments to the C&S Rules and Procedures to provide NZX and CHO with a general discretion to require monthly client position reporting, including where no Position Limits apply to a derivatives contract.



These amendments will allow:

- NZX to require a Trading Participant to report position information in relation to its Client who is party to a Client Agreement (refer to Derivatives Rule 8.1.2 and Procedure 8.9), and
- CHO to require a Clearing Participant to report position information in relation to its direct Customer who is party to a C&S Agreement (refer to C&S Rule 3.2.5 and Procedure 3.2.4).

NZX will be entitled to share the position reports it receives with CHO, where doing so is necessary or desirable to ensure the integrity, certainty or orderly functioning of the clearing house.

NZX and CHO will have a general discretion to determine the nature of the information to be included in the position reporting, and the frequency of that reporting. NZX and CHO intend that the position report for the NZX 20 Futures Contract will be required to include the client's legal name, and total long daily position and total short daily position for each individual derivatives contract, and will usually be required on a monthly basis with reports being required to be provided within 5 business days after the last calendar day of the month. NZX and CHO have a general discretion to require more frequent reporting, where necessary.

This information will help NZX and CHO to better understand the distribution of derivatives contract positions across clients and the associated concentration risks of those exposures, and will improve CHO's arrangements for client portability in the event of a Clearing Participant default.

### **Eligible Collateral**

We are also proposing to amend C&S Procedure 3.18 to enable CHO to accept Fund Securities of a managed investment scheme that is listed on the NZX Main Board which invests in Issuers all or some of whom are constituents in the S&P NZX 50 Index, and which are published by CHO on its website.

CHO initially intends to identify Fund Securities of Smartshares Limited's S&P/NZX 50 ETF (NZG), NZ Mid Cap ETF (MDZ), and NZ Top 10 ETF (TNZ) as Approved Products, but may in future identify Approved Products from managed investment funds managed by alternative fund managers.

We are also proposing amendments to C&S Procedure 3.17 and 3.18 to allow CHO to specify the types of Money and Eligible Securities that it currently accepts as Eligible Collateral on CHO's website. We also propose to include a more general power for CHO to refuse to accept the types of Money and Eligible Securities specified in the Procedures as Eligible Collateral in certain circumstances.

### **Valuation/Haircuts**

In order to preserve flexibility, we are proposing to amend C&S Rule 3.13.2 and remove C&S Procedure 3.19, to enable CHO to publish on its website the details of the manner in which it will determine the valuation of Eligible Collateral, including the Haircut rates that will apply to Eligible Collateral.



CHO intends to remove some of the valuation methodology currently contained in C&S Procedure 3.19 as it relates to certain Collateral Types that are not currently accepted by CHO.

### **Set-Off**

We are proposing to amend C&S Rule 7.8.1 so that CHO is no longer prohibited from setting off amounts owed by CHO to a Clearing Participant in relation to positions and transactions recorded against a House Account (House gains), against amounts owed by a Clearing Participant to CHO in relation to positions and transactions recorded against a Customer Account (Customer losses). CHO will continue to be unable to set off House losses against Customer gains.

This amendment provides more flexibility for CHO to manage a default situation, and is consistent with the requirements of the Financial Market Infrastructures Act 2021 Standards, which provides that an FMI's segregation and portability arrangements must effectively protect the positions of an FMI's participant's customers and related collateral from the default or insolvency of that participant.

### **Consultation Questions – Amendments to support the relaunch**

1. Do you agree that quarterly rather than monthly compliance attestation reporting periods will lower the compliance reporting burden on Participants?
2. Are there any aspects of the existing compliance attestations that you consider should be removed or amended, if so why?
3. Do you have any comments in relation to the proposed position reporting requirements?
4. Do you have any comments in relation to the increased range of eligible collateral types or the proposed changes to provide CHO with more flexibility to manage a default situation?

