

Summary

This Practice Note explains the contractual requirements for C&S Agreements, including where Participants utilise third-party clearing services in respect of Settlement Transactions arising from Derivatives Contracts traded on the NZX Derivatives Market.

Relevant Rules:

New Zealand Clearing Limited Clearing & Settlement Rules (**Rules**). Refer to Rule 2.14.

Under Rule 1.8.1 NZX Limited (**NZX**), New Zealand Clearing Limited (**CHO**), and New Zealand Depository Limited (**CDO**) may act by and through NZX Regulation Limited (**NZ RegCo**) in performing any function or discharging any power set out in the Rules. References in this Practice Note and the Rules to NZX, CHO and CDO therefore also include NZ RegCo in relation to any regulatory activity or discretion.

Capitalised terms in this Practice Note bear the meaning contained in the Rules, NZX Derivatives Market Rules and NZX Participant Rules, as the context requires.

Background

Rule 2.14 requires each General Clearing Participant to enter into and maintain a C&S Agreement with each person for whom it will provide clearing and settlement services and to notify CHO in writing of each C&S Agreement it enters into and the terms and conditions of that agreement.

Rule 2.14 also requires certain content to be included in C&S Agreements, including the content required by the Clearing and Settlement Procedures (**Procedures**). While a C&S Agreement may include terms and conditions other than those required by the Rules, no term or condition in a C&S Agreement may be inconsistent with the terms and conditions that are required by the Rules and Procedures.

This Practice Note contains template language that may be included in C&S Agreements to meet the requirements of Rule 2.14. The explanatory notes provide further guidance as to how these provisions are to be interpreted.

In addition, C&S Agreements must address the matters required by Procedure 2.37, which are not captured within this Practice Note.

NZ RegCo and CHO expect General Clearing Participants to ensure that the contractual arrangements they have in place to provide clearing and settlement services in relation to Settlement Transactions arising from trades on NZX's markets, reflect the clearing model that is being provided to the Trading Participant and its Client (being a person who has entered into a client agreement with a Trading Participant).

The client agreement requirements under the NZX Participant Rules and NZX Derivatives Market Rules (together, the **Trading Rules**) also require Trading Participants to ensure that disclosure is provided to a Client relating to the clearing and settlement arrangements for their Trades.

Third-party clearing models for NZX's markets

Third-party clearing, where an NZX Trading Participant engages a third-party General Clearing Participant to provide clearing and settlement services in relation to its Trading on NZX's markets, is facilitated by NZX's regulatory settings, for both NZX's cash markets and the NZX Derivatives Market.

General Clearing Participants may use models to facilitate clearing and settlement of Trades conducted on NZX's markets, that meet the requirements of the Rules. General Clearing Participants can use different models for different Customers. The models that are currently utilised are explained further below.

Conduit Model

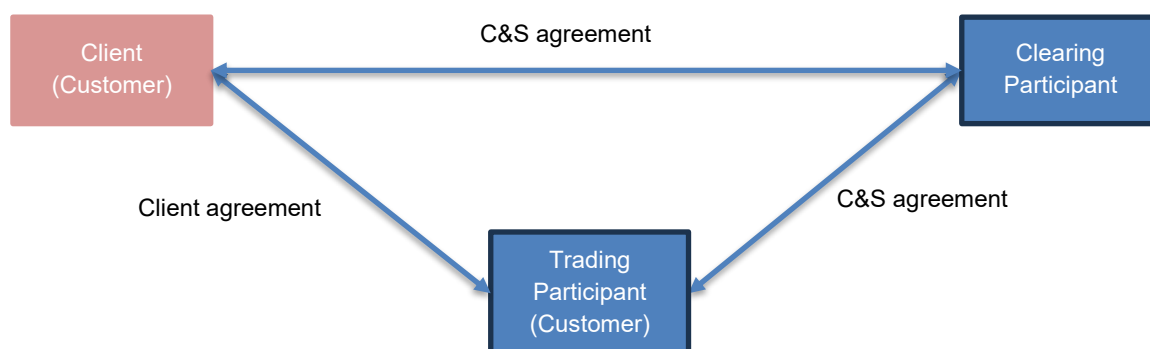


The Rules and Trading Rules permit a clearing and settlement model whereby the Clearing Participant and Trading Participant hold the only C&S Agreement for the clearing and settlement of a Client's Trades. The Client is not the Customer of the General Clearing Participant, rather the Trading Participant is the Customer.

Under this model, in relation to the NZX Derivatives Market, where CHO makes a margin call in relation to a Settlement Transaction arising from a Derivatives Contract, the General Clearing Participant makes a margin call on the Trading Participant under Rule 3.17.1, who in turn may make a call on its Client to meet the margin call under the terms of its Client Agreement¹.

The Conduit Model is available for the settlement of Trades on both NZX's cash markets and the NZX Derivatives Market.

Direct Clearing Model



This model is currently only available for the NZX Derivatives Market.

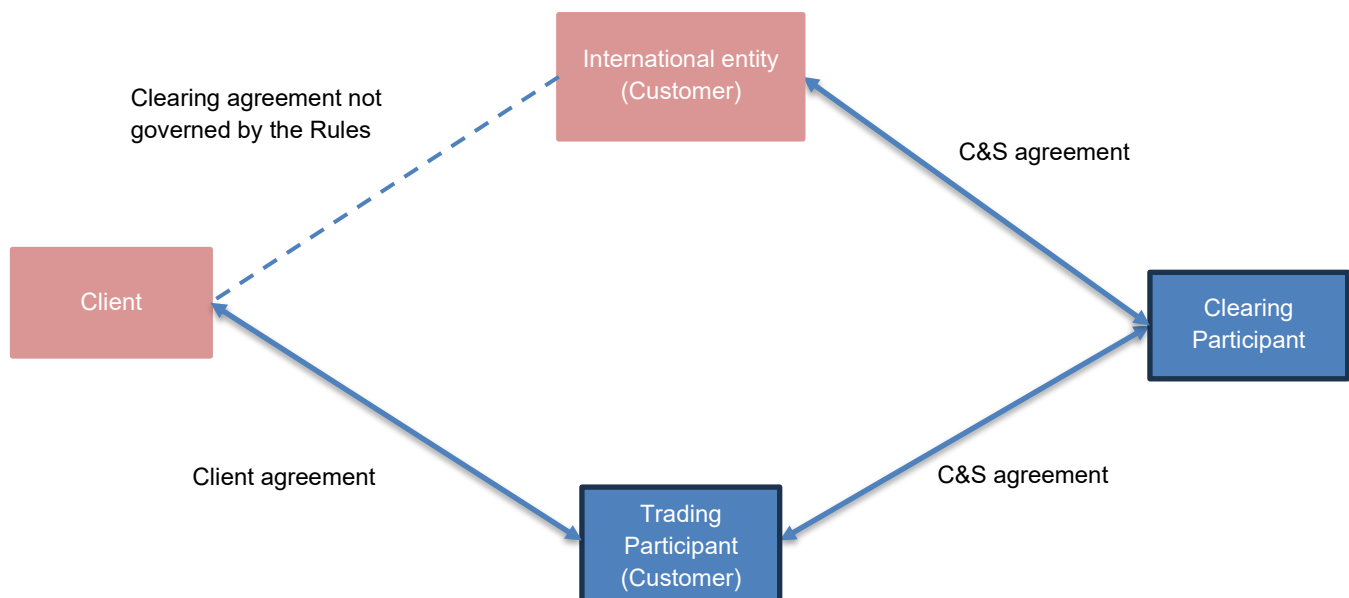
In this model the Trading Participant's Client holds a C&S Agreement directly with the Clearing Participant for the clearing and settlement of its Trades. This enables the Clearing Participant to make

¹ Refer to NZX Derivatives Market Rule 9.5.1(a) and 9.10.

margin calls directly on the Client (which is also its Customer), under Rule 3.17.1. The Clearing Participant does not make margin calls on the Trading Participant under the C&S Agreement it holds with the Trading Participant, because the Settlement Transactions arising from the Client's Trade are allocated to the Client within the Customer Account and therefore relate to the Client rather than to the Trading Participant.

The Trading Participant continues to hold a C&S Agreement with the Clearing Participant to allow it to allocate the Trade to the Clearing Participant for clearing and settlement.

International Model



This model is currently only available for the NZX Derivatives Market.

This model is a variant of the Direct Clearing model and is usually used where the Clearing Participant wishes to paper Clients through a sister entity located in an alternative jurisdiction who is the Clearing Participant's Customer.

In this model the Customer agrees with the Clearing Participant to be responsible for the margin calls relating to the Settlement Transaction arising from the Client's Trade, and the Customer has a direct C&S Agreement with the Clearing Participant. The Settlement Transaction arising from the Client's Trade is allocated to the Customer within the Customer Account, and so the Clearing Participant makes a margin call on the Customer in relation to the position, rather than the Trading Participant.

The Client has a clearing and settlement relationship with the Customer that is not governed by the Rules, although the Customer is required to confirm in its C&S Agreement with the Clearing Participant that it has included certain terms in its agreement with the Client, relating to novation, disclosure of the client funds protections that apply to the Client's funds, and indemnities for NZX and CHO.

The Trading Participant continues to hold a C&S Agreement with the Clearing Participant to allow it to allocate the Trade to the Clearing Participant for clearing and settlement.



C&S Agreement: Content Requirements

Further information is set out below regarding the standard terms and conditions to be contained in a C&S Agreement (that are required by C&S Rule 2.14, or by operation of the Trading Rules). Optional suggested template language is included in the blue boxes below, along with explanatory notes that explain how the terms and conditions should be interpreted in the context of the clearing models.

Capitalised terms should be defined in the C&S Agreement to bear the same meaning as contained in the Rules. This includes the term 'Rule' which is defined in the Rules as the New Zealand Clearing Limited Clearing & Settlement Rules.

The language provided below, is intended to support Clearing and Trading Participants in complying with their obligations in relation to the content of C&S Agreements. Participants may elect to use alternative language to meet those obligations from that set out below.

In addition, C&S Agreements must include the provisions required by Procedure 2.37, which are not captured within this Practice Note.

Trading Participants who are using third-party clearing arrangements also need to ensure that the C&S Agreement allows them to meet their obligations under the Trading Rules.

Application of Rules (Rule 2.14.3(a))

The Customer and the Clearing Participant agree that the terms of their relationship in respect of Transactions and any dealings between them concerning Approved Products are subject to, and that the parties are bound by:

- (a) applicable Securities Legislation;
- (b) the Rules and the Procedures; and
- (c) this C&S Agreement.

Explanatory Note: This provision is relevant for all clearing models as it ensures that the clearing and settlement relationship between the Clearing Participant and its Customer is governed by the Rules and applicable law.

Responsibility for clearing and settlement (Trading Rules)

The Clearing Participant agrees that it will provide clearing and settlement services for all Settlement Transactions arising from Trades allocated to it by the Customer for clearing and settlement.

The term Trades bears the meaning contained in the [NZX Derivatives Market Rules / NZX Participant Rules].

Explanatory Note: This provision is only required in C&S Agreements where the Trading Participant is the Customer.

In all third-party clearing models, the Trading Participant continues to hold a C&S Agreement with the Clearing Participant to meet its obligations under the Trading Rules to have a C&S Agreement in place with a Clearing Participant with whom it has third-party clearing arrangements, and to ensure that under

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such arrangements the Clearing Participant has obligations to clear and settle all Trades allocated to the Clearing Participant².

These arrangements allow the Trading Participant to identify the Clearing Participant as responsible for the clearing and settlement of the Trade³.

Novation (Rules 2.14.3(b) and 2.14.3(c)(i))

- [x] The Customer and the Clearing Participant acknowledge every Transaction subject to clearing on the Clearing House will be novated and the Clearing and Settlement Terms of the Transaction will be cancelled and replaced by two separate and independent settlement transactions comprising:
- a) a Settlement Transaction between the buyer's Clearing Participant (in substitution for the buyer in respect of the Transaction) and CHO for the seller in respect of the Transaction; and
 - b) a Settlement Transaction between the seller's Clearing Participant (in substitution for the seller in respect of the transaction), and CHO in substitution for the buyer in respect of the transaction.

The Customer and Clearing Participant acknowledge, that the novation, cancellation and replacement of the Clearing and Settlement Terms of the Transaction referred to in clause [x] will occur as set out in Rule 3.3, such that in the case of a:

- a) Mandatory Transaction, immediately upon entry into a Transaction under the rules of a relevant NZX Market, and
- b) Discretionary Transaction, immediately upon notice of acceptance of the Transaction for clearing and settlement on the Clearing house by CHO.

The Customer and the Clearing Participant acknowledge and agree to the full extent required by law that the Clearing Participant will become principal in the resulting Settlement Transaction that arises under clause [x] and take on all of the delivery and settlement obligations for that Settlement Transaction.

The Customer acknowledges and agrees that any benefit or right obtained by the Clearing Participant, or any other legal result, upon the novation of Transactions is personal to the Clearing Participant and the benefit of that benefit, right, or legal result does not pass to the Customer.

The Customer acknowledges and agrees that the Customer has no rights, whether by way of subrogation or otherwise, against CHO in relation to any Transaction that has been novated, in accordance with clause [x] and Rule 3.3.

Explanatory note: In relation to all clearing models, these provisions ensure that the settlement obligations arising from a Trade are instantly novated and replaced, such that the Clearing Participant has obligations to CHO as principal, for the Settlement Transaction.

² NZX Derivatives Market Rule 7.1.2 and 7.2.1. NZX Participant Rule 6.1.2 and 6.2.1.

³ NZX Derivatives Market Rule 7.2.3. NZX Participant Rule 6.2.3.



Limitation of liability for CHO and Affected Persons (Rule 2.14.3(c)(ii) and (iii))

The Customer acknowledges and agrees that the liability of CHO and/or any Affected Persons to any Person, including the Customer, is limited or excluded by, and subject to, the provisions of Rule 8.1.

The Customer acknowledges and agrees that the liability of any Affected Person (as defined under Depository Rule 9.5) to any Person including the Customer is limited by, and subject to, the provisions of Depository Rule 9.1.

Explanatory note: These provisions apply in relation to all clearing models and provide appropriate limitation of liability protections to CHO and Affected Persons (being broadly NZX, New Zealand Clearing and Depository Corporation Limited, New Zealand Clearing Limited, New Zealand Depository Limited and their directors and employees).

Customer's clearing and settlement agreements (Rule 2.14.3(c)(iv))

The Customer acknowledges and agrees that each clearing and settlement agreement it enters into between itself and its clients includes:

- (a) the disclosures, statements, and other provisions as are required by the rules of the relevant NZX Market to be included in a client agreement in relation to clearing and settlement of Transactions;
- (b) a statement that the Customer's client acknowledges and agrees that the liability of CHO, and/or any Affected Person, to any Person (including the Customer's client) is limited or excluded by, and subject to, the provisions of Rule 8.1;
- (c) a statement that the Customer's client acknowledges and agrees that every Transaction subject to clearing on the Clearing House will be novated in accordance with the Rules; and
- (d) *[a description of the client funds protections that apply to assets provided to the Customer in relation to the clearing and settlement of Transactions relating to the Customer's client].*

Explanatory note - general: This provision is relevant where a Customer provides clearing and settlement services to an underlying client. It provides further protection to the Clearing Participant that entities for which the Customer is providing services have been provided appropriate disclosures in relation to the operation of the Rules in relation to the Settlement Transaction.

In relation to the C&S Agreement between a Trading Participant as Customer and a Clearing Participant, the Trading Participant will be able to provide the required acknowledgements so long as it complies with its obligations in relation to the required content for a client agreement under the Trading Rules.

Explanatory note - clause (a): As noted above where the Customer is the Trading Participant it will be able to provide a confirmation that meets the requirements of clause (a) where it complies with its obligations in relation to the required content for a client agreement under the Trading Rules.

Where the Customer is not a Trading Participant, and is providing clearing and settlement services to a client (which occurs in the International Model) the Customer should ensure that its clearing and settlement agreement with its client contains a statement to the effect that:

the client grants to the Customer, at all times, full and exclusive rights, power, and authority to act in all of the Customer's activities with the Clearing Participant relating to Settlement Transactions arising from the client's Transactions to the exclusion of the client.

Explanatory note - clause (d): Clause (d) is only relevant where the Customer is providing clearing and settlement services in relation to Settlement Transactions arising from Derivatives Contracts.

Where the Customer is a Trading Participant it will be able to provide this confirmation to the Clearing Participant so long as it complies with its obligations in relation to the required content for a Client Agreement under the NZX Derivatives Market Rules.

This provision is particularly relevant for the International Model where the Customer is unlikely to be subject to regulations 238 to 250 of the Financial Markets Conduct Regulations 2014 (**Client Funds Regulations**). We expect that to be able to provide the required confirmation in the C&S Agreement, the Customer will need to ensure that it has provided a disclosure as to whether the Client Funds Regulations apply to its holding of settlement funds from its client. If the Client Funds Regulations do not apply, we would expect that a high-level description of whether client funds protections apply under local law, and the nature of those protections (including whether the client's funds are held in a trust account and whether they are held on a segregated basis) to be included in the clearing and settlement agreement between the Customer and its client.

Full and exclusive rights (Rule 2.14.3(d))

The Customer acknowledges and agrees that in respect of a Transaction to be cleared and settled in accordance with the Rules, the Clearing Participant has and shall have, at all times, the full and exclusive rights, powers and authority to act in all of its activities with CHO to the exclusion of any other Person (including any client or other Person on whose behalf the Customer is acting), including full authority to bind the original party to the Transaction to these Rules and authorise the dealing of that Person's Admitted Product in the Depository in accordance with the Rules.

Explanatory note: In relation to all clearing models, these provisions ensure that the Clearing Participant has obligations to CHO as principal.

Appointment of CHO (Rule 2.14.3(e))

The Clearing Participant and Customer irrevocably and severally appoint CHO, and every Director or Personnel for the time being of CHO, at the option of CHO to do all acts and execute all documents on the Clearing Participant's or Customer's behalf for the purpose of exercising the powers conferred on CHO under the Rules, including the power to:

- (a) buy or sell approved products, or
- (b) give-up, take-up, dispose of, close out, or otherwise acquire Settlement Transactions.

Explanatory note: In relation to all clearing models, these provisions support the operation of the Rules in relation to the clearing and settlement of Settlement Transactions and CHO's ability to exercise its powers under the Rules.

Inconsistencies (Rule 2.14.3(f))

The Customer and the Clearing Participant acknowledge and agree that, to the extent that there are any inconsistencies between this Agreement and the Rules, the Rules will prevail and apply as though the Customer and the Clearing Participant had agreed and entered into an agreement consistent with the Rules.



Explanatory note: In relation to all clearing models, these provisions support the primacy and priority of the Rules over the provisions contained in the C&S Agreement.

Margin calls (Rule 2.14.3(m))

The Customer agrees that it will pay to the Clearing Participant any amounts that the Clearing Participant has asked the Customer to pay in accordance with Rule 3.17.1, or will provide security for such an amount that is acceptable to the Clearing Participant, no later than:
[the time specified by the Clearing Participant which must be no later than 48 hours after the request for payment by the Clearing Participant] / [24 hours after the request for payment by the Clearing Participant].

Explanatory note: This provision applies where the Clearing Participant is providing clearing and settlement services in relation to Settlement Transactions arising from Derivatives Contracts.

In all models this provision empowers the Clearing Participant to make a margin call from the Customer. The Clearing Participant may specify in the C&S Agreement a time by which payments must be made so long as the specified time is not later than 48 hours after the Clearing Participant has made the call. Where the Clearing Participant does not specify a time for payment in the C&S Agreement, the agreement must specify that the payment must be made within 24 hours after the request by the Clearing Participant is made to the Customer.

Under Rule 3.17.1 the Clearing Participant must call margin from a Customer in relation to Settlement Transactions arising from a Derivatives Contract which *relate to* the Customer to ensure that the Clearing Participant is able to satisfy its obligations to CHO in relation to those Settlement Transactions. This clause enables the Clearing Participant to make that call on the Customer through the operation of the C&S Agreement which sets out the contractual arrangements between the Clearing Participant and Customer.

Whether a Settlement Transaction relates to a Customer will be determined by the Customer to whom the transaction is allocated within the Customer Account.

In the Conduit Model the Settlement Transaction will be allocated to the Trading Participant within the Customer Account. As such, the Clearing Participant will call margin for the Settlement Transaction from the Trading Participant.

In the Direct Clearing model, the Settlement Transaction will be allocated to the Client within the Customer Account. As such, the Clearing Participant will call margin for the Settlement Transaction directly from the Client.

In the International Model, the Settlement Transaction will be allocated to the international entity Customer within the Customer Account. As such, the Clearing Participant will call margin for the Settlement Transaction directly from the international entity Customer.

Amendment and Termination of this Agreement (Rules 2.14.3 (g),(h),(i),(j),(k) and (l))

The Customer and Clearing Participant agree that:

- (a) the Clearing Participant must notify CHO in writing of any material changes to this agreement at least 10 Business Days before the amendment becomes effective;
- (b) they will make (at their own cost) any amendments to this agreement as may reasonably be required from time to time by CHO;
- (c) the Clearing Participant must notify CHO in writing if it intends to terminate this agreement, with the time and date of the intended termination;
- (d) any purported termination shall be subject to the rules of any NZX Market in respect of which the Clearing Participant provides clearing and settlement services under this Agreement;

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- (e) any purported termination of this Agreement is not effective until CHO accepts such termination in writing. CHO may have regard to any matter it thinks fit when determining whether to accept the request for termination, including the matters set out in Rule 2.14.3(k); and
- (f) unless alternative arrangements have been made for the settlement, close out, or give-up take-up of any Settlement Transactions of the Clearing Participant in relation to the Customer, the Clearing Participant continues to have the obligation for Settlement Transactions that relate to the Customer prior to the termination of this Agreement.

Explanatory note: In relation to all clearing models, these provisions ensure that there is agreement from the Customer as to the effectiveness of amendments to and/or termination of the C&S Agreement and that termination of a C&S Agreement does not remove the obligations of the Clearing Participant related to Settlement Transactions that exist prior to acceptance of the termination.