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**Disclaimer**

This guidance note has been issued to promote commercial certainty and assist market participants. It provides guidance to Market Participants and their advisors on NZX's interpretation of the NZX Participant Rules. This Guidance Note sets out NZX's general approach to the subject, but is not to be regarded as a definitive statement of the application of the Rules in every situation. Guidance Notes do not constitute legal advice and are only a guide to NZX's policy & practice. NZX recommends that Market Participants take advice from qualified professionals.

## **GUIDANCE NOTE GN0012/06 - INFORMATION CONTROLS AT NZX MARKET PARTICIPANTS**

### **INTRODUCTION**

This Guidance Note is published to provide guidance to NZX Market Participants in the interpretation of those Participant Rules that relate to information control mechanisms or “Chinese Walls”. This note also discusses similar obligations that arise elsewhere. While it is outside the remit of NZX to provide guidance on obligations, including obligations that arise at law, which it has not itself imposed, we consider that this discussion will prove beneficial to Market Participants on the issue of Chinese Walls.

### **BACKGROUND**

Chinese Wall considerations will be relevant for firms that perform activities in the course of which their representatives may come into contact with non-public, price sensitive information (“NPPSI”) that relates to issuers of listed securities. This is most likely to occur at a firm that provides investment banking and/or corporate advisory services in addition to executing and/or providing advice in relation to transactions in securities listed on an exchange (i.e. broking). That said any participant may come into contact with NPPSI from time to time. Accordingly, a Chinese Wall can be a temporary measure in addition to a permanent barrier between business units of a firm.

### **CHINESE WALLS AS “GOOD PRACTICE”**

On 14 November 2005, the Securities Commission released a report entitled “*Information Control in Market Participants: Report of an inquiry into trading in the shares of Wrightson Limited in June 2004*”. At the time of the writing of this note, this report may be viewed on the Commission's website.

The subject of the report was the handling of information that was potentially NPPSI relating to a takeover for which a NZX Market Participant was acting for the offeror. The Commission found that this information had been selectively disclosed by the Market Participant to select firms and its own client advisors ahead of the market at large being informed. In the report and the accompanying press release, the Commission described this conduct as being, not unlawful, but inappropriate and not acceptable practice.

The Commission went on to say that the situation illustrated the need for market participants (a group which includes NZX Market Participants) to have good information controls. The Commission said that this was for two reasons:

- (1) to reduce the chances of inadvertent corporate liability for insider trading; and
- (2) as a matter of good market practice.

Regarding the latter the Commission said that “. . . *selective disclosure . . . creates information asymmetries and proves some traders with an advantage over others in the market. It is incumbent upon market participants operating both investment banking and broking activities to ensure this does not occur.*”

NZX notes the Commission’s power to review and comment in regard to practices relating to securities at section 10 of the Securities Act 1978. NZX sees the Commission’s report as a statement of its expectations for the handling and treatment of information that is potentially NPPSI whether or not that information constitutes Inside Information, as defined from time to time by the Securities Markets Act 1988. The treatment and handling of Inside Information itself is further regulated by the statute. In addition, the Commission’s expectations are that organisations that provide investment banking and/or corporate advisory services in addition to executing and/or providing advice in relation to transactions in securities and investments have policies and procedures in place for the handling of NPPSI and also that relevant people are aware of and adhere to these procedures. NZX shares these expectations with regard to NZX Market Participants whose business lines of activity bring them into this scope.

NZX recommends that Market Participants pay regard to the Commission’s views and expectations in respect of potential NPPSI and seek to ensure that their conduct always meets these expectations.

While NZX is unable to add any clarification to the Commission’s views on the matter (such queries should be directed to the Commission itself), NZX recommends that Market Participants adopt a prudent approach in the location of their Chinese Walls and in assessing what is potentially NPPSI and/or Inside Information to ensure that the special handling of the information per the established procedures occurs when necessary. It might be that Inside Information is indistinguishable with any great clarity from NPPSI that is *not* Inside Information at the relevant time. Moreover, Market Participants will need to keep abreast of the imminent changes to Insider Trading law which broaden the definition Inside Information.

## CHINESE WALLS IN THE PARTICIPANT RULES

Chinese Walls are referred to in the Participant Rules at Participant Rule 3.23 which provides (at the date of this Guidance Note) that an application for designation as a Market Participant must contain an outline of the applicant's practices and procedures to avoid and/or control any actual or potential conflict of interest which may arise as a result of the different business activities of the applicant.

Please note that changes to Participant Rule 3.23 proposed at the time of writing seek to recognise that not all applicants seeking to become an NZX Market Participant will require a Chinese Wall and that the trigger for this requirement is not necessarily an application for accreditation in more than one class of participant (such as a trading and settling participant).

NZX also considers that its remit with regard to Chinese Walls arises as a result of the fact that it supervises the broking activities of Market Participants including an assessment of compliance with the requirement at Participant Rule 8.1.2 to observe Good Broking Practice.

NZX's remit with regard to Chinese Walls ceases at the point that the law takes over.

NZX will consider a Market Participant's Chinese Wall policies and procedures at the time of its application. Thereafter, NZX may assess the Market Participant's Chinese Wall in the course of its regulatory supervision of each Market Participant. Such assessment shall involve a consideration of:

- the physical location of different business units, in particular, investment banking on the one hand and broking/advising on the other
- the electronic separation of business units (i.e. the necessary restriction of access to information in network drives and folders)
- formal written procedures (where such arrangements are not committed to writing this considerably reduces the likelihood that the procedures are known and understood by staff and will ultimately be adhered to)
- training of all relevant staff (which is likely to be all staff within the firm) as to the firm's information control procedures and their critical importance
- formal procedures and records relating to situations in which individuals (such as analysts, dealers or advisors) temporarily cross the Chinese Wall.

## CHINESE WALLS AT LAW

The only legislative reference to Chinese Walls arises at section 8(3) of the Securities Markets Act 1988. This section outlines exceptions or defences to the offence of insider trading at section 7 of that Act. As this is a matter of legal compliance (rather than its own

rules compliance), NZX is unable to provide any advice on what the requirements of a Chinese Wall that would satisfy section 8(3) would be.

A legal obligation to keep information confidential may also arise out of a Market Participant's common law or contractual law duties and obligations to clients. This will trigger the need for Chinese Wall procedures notwithstanding that the information is not potential NPPSI.

## **DISCLOSURE CONSIDERATIONS**

The situation the subject of the Commission's report highlighted the importance of handling NPPSI appropriately pending its disclosure generally. Such general disclosure may occur, say, through the market announcement platform of an exchange when the information relates to a listed issuer. In this regard, we note that a key function of Continuous Disclosure obligations is the desire to restrict as far as possible the window of opportunity for Insider Trading. Disclosure could also occur by the filing by a Substantial Security Holder. The timeframe imposed by disclosure obligations may differ. On occasions, certain types of NPPSI may not be subject to any disclosure obligations and time within which it becomes generally known may not be fixed or certain. Such considerations should be taken into account in the proper handling of potential NPPSI.