

## SECTION 15

### CAPITAL ADEQUACY

#### 15.1 GENERAL

**15.1.1** The capital adequacy of a Market Participant Requiring Liquid Capital shall be calculated in accordance with Generally Accepted Accounting Practice, **subject to this Section 15**. Generally Accepted Accounting Practice shall be applied so as to ensure a true and fair assessment of the extent of a Market Participant Requiring Liquid Capital's compliance with this **Section 15**.  
*(Amended 28/2/07)*

**15.1.2** To ensure that each Market Participant Requiring Liquid Capital is at all times capable of meeting its financial obligations, each Market Participant Requiring Liquid Capital must at all times maintain its Liquid Capital at, or above, the prescribed level, except as otherwise provided in **Rule 15.10.2**.  
*(Amended 28/2/07)*

#### 15.2 CURRENT ASSETS

**Current Assets** means all current assets of a Market Participant Requiring Liquid Capital, as defined by Generally Accepted Accounting Practice and:  
*(Amended 28/2/07)*

- (a) Includes:
  - (i) facilities or agreements which give that Market Participant Requiring Liquid Capital an unconditional right, or a right subject only to the condition of not more than **3 Business Days notice**, to require the grantor of the facility to provide additional funds to that Market Participant Requiring Liquid Capital and which:
    - (1) is given by a person approved by NZX (which approval may be withdrawn at any time);
    - (2) is evidenced by a deed or agreement in a form approved by NZX;
    - (3) (if the facility provides for a loan), must be in the same

form as subordinated loans acceptable under Rule 15.5;

- (4) must be unconditional, or conditional only as to drawdown notice; and
  - (5) must be expressly stated in the documents evidencing the facility to be for the benefit of, and enforceable by, creditors of the Market Participant Requiring Liquid Capital and NZX and provide for amendment only with the consent of NZX; *(Amended 28/2/07)*
- (ii) an irrevocable guarantee or bond in a form approved by NZX, given by a Bank or other person approved by NZX, which creates an unconditional obligation on the grantor to make payments on demand for the purpose of contributing to the Liquid Capital of that Market Participant Requiring Liquid Capital. The amount guaranteed or bond will be restricted to the amount stated on the face of the guarantee or bond and the guarantee or bond shall not be cancelled or amended without the approval of NZX. NZX may at any time withdraw its approval of a grantor, in which case the guarantee or bond will no longer meet the requirements of this **Rule 15.2(a)**, *(Amended 28/2/07)*

provided that the aggregate of assets calculated in accordance with **Rule 15.2(a)(i)** and **(ii)** does not exceed the ratio of 50/50 of the Market Participant Requiring Liquid Capital's Current Equity unless the aggregate of assets calculated in accordance with **Rule 15.2(a)(i)** and **(ii)** is for a loan, guarantee, bond, facility or arrangement for a period of 3 months or less (**short term**) and for a specific transaction of that Market Participant Requiring Liquid Capital's Broking Business and that Market Participant Requiring Liquid Capital has been granted a waiver in accordance with this **Rule 15.2**. If the loan, guarantee, bond, facility or arrangement is short term that Market Participant Requiring Liquid Capital must: *(Amended 28/2/07)*

- (1) notify NZX in writing that a short term loan, guarantee, bond, facility or arrangement is required; *(Amended 28/2/07)*
- (2) detail the purpose of the loan, guarantee, bond, facility or arrangement; and

- (3) request from NZX a waiver from the requirements of this Rule 15.2.

For the avoidance of doubt NZX, at its complete discretion, may refuse to grant a waiver from this **Rule 15.2** requested by that Market Participant Requiring Liquid Capital and NZX may at its complete discretion require that Market Participant Requiring Liquid Capital to apply any additional risk based reduction NZX considers, in its complete discretion, to be reasonable; and *(Amended 28/2/07)*

(b) Excludes:

- (i) Securities or current assets which have no ready market;
- (ii) any debt over **10 Business Days** old **except** where:
  - (1) NZX is satisfied that this leads to a material underestimation of Current Assets; or *(Amended 28/2/07)*
  - (2) that Market Participant Requiring Liquid Capital holds, in a Nominee Account, Securities against the amount outstanding with a current market value of at least 140% of that amount outstanding. A condition of this exception is that that Market Participant Requiring Liquid Capital provides a separate balance sheet item for the activities of margin lending against Securities;
- (iii) all loans and advances to, or amounts owing by, any partners, Employees or persons associated with that Market Participant Requiring Liquid Capital, and their Immediate Family, or any Family Trust or Family Companies of those persons, any parent or Subsidiary companies, related parties or any parties having any other financial or Trading interest in that Market Participant Requiring Liquid Capital, **except**:
  - (1) any such loans, advances or amounts owing that are unconditionally guaranteed (which guarantee is subject only to the condition that the debtor has failed to pay the amount owing):
    - (AA) by a person approved by NZX (which approval may be withdrawn at any time); and

- (BB) evidenced by a deed in the form provided from time to time by NZX;
- (2) where the amount in question arises through a transaction undertaken by that Market Participant Requiring Liquid Capital on behalf of the other party, and which is subject to normal trading settlement terms;
- (iv) all fixed assets including property;
- (v) goodwill; and
- (vi) intangible assets including intellectual property.

### 15.3 EXTERNAL LIABILITIES

15.3.1 For the purpose of calculating a Market Participant Requiring Liquid Capital's actual Liquid Capital **Gross External Liabilities**:

- (a) Includes each Market Participant Requiring Liquid Capital's:
  - (i) total gross liabilities; and
  - (ii) current, long-term and contingent liabilities and;
- (b) Excludes:
  - (i) that Market Participant Requiring Liquid Capital shareholders' funds comprising paid up capital, retained earnings (after tax, or after provision for tax on year-to-date earnings) and realised reserves or any other reserves approved by NZX, where the Market Participant Requiring Liquid Capital is a company. Shareholders' funds may include redeemable preference shares when these are issued in accordance with a deed, and are on terms approved by NZX; *(Amended 28/2/07)*
  - (ii) partners' capital (in the form of current or capital account balances, loans from partners, retained earnings of the partnership, realised reserves or any other form of liability to any or all of the partners, where the Market Participant Requiring Liquid Capital is a partnership);

(iii) Subordinated loans made to that Market Participant Requiring Liquid Capital where such loan is evidenced in writing in accordance with **Rule 15.5** and with the subordination confirmed by a trust, in a form approved by NZX; and

(c) Debit and credit balances for which a legal right of set-off exists may be treated as a net balance.

**15.3.2** For calculations of Prescribed Liquid Capital **Rule 15.3.1** shall apply in its entirety.

## **15.4 DISCLOSURE OF CONTINGENT LIABILITIES**

Any and all other undertakings, guarantees, promises and obligations provided by a Market Participant Requiring Liquid Capital or claims against it, including any current, threatened or pending legal proceedings, which are not recorded as balance sheet items but have the effect of either actually or potentially increasing the liabilities or decreasing the assets of that Market Participant Requiring Liquid Capital must be disclosed to NZX. NZX will determine the appropriate increase to be applied to the level of Gross External Liabilities, if any, or, whether in the particular circumstances, an adjustment to reduce the level of Current Assets is appropriate.

*(Amended 28/2/07)*

## **15.5 SUBORDINATED LOANS**

**15.5.1** Subordinated loans (which may not exceed the ratio of 50/50 of the Market Participant Requiring Liquid Capital's Current Equity, subject to **Rule 15.10.2**) must be evidenced by an agreement in writing, between the parties in a form of subordinated loan agreement approved by NZX. The subordinated loan agreement must, as a minimum, include the following:

(a) A provision that the agreement must not be amended **except** in writing signed by the parties and approved by NZX;

(b) The terms and conditions governing each loan;

(c) That repayment of the loan in whole or in part must not take place without the prior approval of NZX. NZX may withhold its consent if it is not satisfied that the Market Participant Requiring Liquid Capital is capable of continuing to comply with the Rules, any directions

given from time to time by NZX, or Good Broking Practice, following the repayment of the loan; *(Amended 28/2/07)*

- (d) an acknowledgment by the lender that:
- (i) any right of the lender to payment in the case of bankruptcy of, or any composition or compromise with creditors by, or appointment of a trustee in bankruptcy, or in the case of liquidation, liquidator of that Market Participant Requiring Liquid Capital who has borrowed from that lender, or the partners, shareholders or directors of that Market Participant Requiring Liquid Capital, or any of them, is extinguished to such extent as will ensure payment, or provision for payment, in full of all claims of all other present and future creditors of that Market Participant Requiring Liquid Capital in priority to the claim of that lender;
  - (ii) any right to receive interest and principal repayments are subordinated, at all times during the term of the loan, to all other creditors; and
  - (iii) the obligation to repay the loan, and to pay interest, is suspended if the Liquid Capital of the Market Participant Requiring Liquid Capital falls below the Prescribed Level of Liquid Capital.

15.5.2 NZX must be satisfied that the borrower has made adequate arrangements to cover its Liquid Capital requirements upon the maturity date of any loan for a fixed term, and must be advised of the full particulars of each loan prior to the loan being accepted.

15.5.3 *(Revoked 28/2/07)*

## 15.6 RISK BASED REDUCTIONS TO CURRENT ASSETS

For the purposes of calculating Liquid Capital, the following reductions to Current Assets (including those assets for which a Market Participant Requiring Liquid Capital is Acting as Principal) shall be applied:

- (a) **Debtors:** NZX will review the policies on managing and providing for bad debts, counterparty risks and price/yield movement risk on

client trades for each Market Participant Requiring Liquid Capital and establish a suitable level of reduction to the client receivables for that Market Participant Requiring Liquid Capital. *(Amended 28/2/07)*

(b) **Equity Securities:**

(i) For Equity Securities held or receivable by each Market Participant Requiring Liquid Capital including short positions:

(1) for NZX 50 Index Equity Securities:

(AA) **5%** for the listed Issuers ranked 1 to 15 by the NZX 50 Index;

(BB) **10%** for the listed Issuers ranked 16 to 50 by the NZX 50 Index; or

(CC) **15%** for all listed Issuers outside the NZX 50 Index;

*(Rule 15.6(b) Amended 28/2/07)*

(2) for foreign leading equities (meaning overseas listed equities in the “blue chip” index of a member exchange of the World Federation of Exchanges or other Securities Exchange recognised by NZX “**Member Exchange**”):

(AA) **6%** for a foreign leading equity ranked 1 to 15 in the leading index of the Member Exchange;

(BB) **12%** for a foreign leading equity ranked 16 to 50 in the leading index of the Member Exchange; or

(CC) **18%** for a foreign leading equity ranked outside the leading index of the Member Exchange;

(3) for rights, the lesser of:

(AA) **100%**; or

(BB) **10%** of the combined value of rights and application monies; and

(4) for other Equity Securities (including partly paid shares), **100%** (or such lesser amount as determined by NZX); and  
(Amended 28/2/07)

(ii) Where net short and long positions by Security are held, positions may not be offset.

**(c) Debt Securities:**

(i) For Current Assets comprising Debt Securities in New Zealand Dollars:

Security Type	NZ Dollar Domiciled Under 1yr	NZ Dollar Domiciled 1-3 yrs	NZ Dollar Domiciled 3-5 yrs	NZ Dollar Domiciled 5+ yrs
<b>Government Securities</b>	0.5%	1.5%	3.0%	5.0%
<b>Investment Grade (Non Govt)</b>	1.5%	3.5%	4.5%	7.0%
<b>Rated Non Investment Grade (Non Govt)</b>	4.0%	7.0%	8.5%	10.0%
<b>Other</b>	6.0%	8.0%	10.0%	12.5%

*Note: All rated Securities must carry a rating by an agency recognised by NZX*

(ii) For Current Assets comprising Debt Securities in foreign currencies:

Security Type	Foreign Currencies Under 1yr	Foreign Currencies 1-3 yrs	Foreign Currencies 3-5 yrs	Foreign Currencies 5+ yrs
<b>Government Securities</b>	0.6%	1.8%	3.6%	6.0%
<b>Investment Grade (Non Govt)</b>	1.8%	4.2%	5.4%	8.4%
<b>Rated Non Investment Grade (Non Govt)</b>	4.8%	9.8%	10.2%	12.0%
<b>Other</b>	7.2%	9.6%	12.0%	15.5%

*Note: All rated Securities must carry a rating by an agency recognised by NZX*  
(Amended 28/2/07)



(d) **Futures positions:**

(i) **Unhedged positions:** For unhedged futures positions (either short or long) a rate appropriate to the underlying Security and based on the gross amount of the underlying Security. For futures contracts, a **10%** reduction will apply except to the extent that such Trading is undertaken as a Futures and Options Participant under the Futures and Option Rules.

(ii) **Hedged positions:** See **Rule 15.7**.

(e) **Options positions:**

(i) For option positions purchased as principal, 100% of their book value. Any unrealised profit may be taken into account as a Current Asset if a reduction to Current Assets has been made by applying the scale in **Rule 15.6(b)** or **(c)** (which ever is applicable) to the value of the underlying Security at market price.

(ii) For covered positions, the premium received may be recorded as a Current Asset. The underlying Security is to be valued at the lower of the option exercise price or the market price with the appropriate reduction to Current Assets being calculated by applying the scale in **Rule 15.6(b)** or **(c)** (which ever is applicable) to that value.

(f) **Underwriting positions:**

(i) If required by NZX, each Market Participant Requiring Liquid Capital acting as underwriter or sub-underwriter to a transaction must supply the following information to NZX:

*(Amended 28/2/07)*

(1) the gross amount being underwritten;

(2) the party to whom the potential liability is owed;

(3) the sub-underwriting parties (if any) who have reduced the size of the underwriting position;

(4) evidence of any sub-underwriting (e.g. confirmation letters) if any;

- (5) the net exposure after any sub-underwriting if any; and
  - (6) any information available regarding the financial position of the sub-underwriter/s if any.
- (ii) For net underwriting positions or pre-listing offers or commitments made by the Market Participant Requiring Liquid Capital to take Equity Securities on a firm basis, the reductions in **Rule 15.6(b)** will apply to the net outstanding principal position value of those positions and/or commitments.
  - (iii) For Debt Securities underwritten by the Market Participant Requiring Liquid Capital, a rate calculated in accordance with the scale in **Rule 15.6(c)** to the net outstanding principal position value of those underwritten Debt Securities.
  - (iv) Where a Market Participant Requiring Liquid Capital enters into Underwriting or sub-underwriting arrangements, and NZX requires daily reporting of its underwriting positions, the reporting will be made in the format of NZX FF4 Report as outlined in the Guidance Notes provided from time to time by NZX.
- (g) **Other non-standard transactions:** All transactions not recorded in the books of account for that Market Participant Requiring Liquid Capital and for which that Market Participant Requiring Liquid Capital is contractually committed must be disclosed to NZX. NZX will, at its complete discretion, determine the appropriate reduction to be applied to the level of current assets, if any. *(Amended 28/2/07)*

## 15.7 HEDGED POSITIONS

15.7.1 Each Market Participant Requiring Liquid Capital that hedges (in other words, takes out futures or options contracts that fully cover the price movement risk) its own principal positions may, with the prior written consent of NZX, net those positions off. *(Amended 28/2/07)*

15.7.2 In general, NZX will give its agreement under **Rule 15.7.1** if a Market Participant Requiring Liquid Capital's futures positions in futures contracts have the top five Securities by market capitalisation matching the weightings of the relevant index. *(Amended 28/2/07)*

- 15.7.3 An additional reduction of Current Assets may be required by NZX to adjust for liquidity or mis-matched maturity risks for Debt Securities.  
*(Amended 28/2/07)*

## 15.8 PRESCRIBED LEVEL OF LIQUID CAPITAL

15.8.1 The Prescribed Level of Liquid Capital for a Market Participant Requiring Liquid Capital is:

- (a) For a Market Participant Requiring Liquid Capital which has been a Market Participant Requiring Liquid Capital for a consecutive period of **12 months** or more, the sum of:
  - (i) **\$100,000;**
  - (ii) **5%** of Gross External Liabilities; and
  - (iii) **5%** of the outstanding net underwriting, sub-underwriting or firm allocation value; or
- (b) For a Market Participant Requiring Liquid Capital which has been a Market Participant Requiring Liquid Capital for a period less than 12 consecutive months, the sum of:
  - (i) **\$250,000;**
  - (ii) **5%** of Gross External Liabilities; and
  - (iii) **5%** of the outstanding net underwriting, sub-underwriting or firm allocation value

15.8.2 NZX, at its complete discretion, may require a Market Participant Requiring Liquid Capital to include a secondary requirement in its liquid capital calculations if NZX determines that the Market Participant is subject to any of the following risks:

- (a) Illiquid assets;
- (b) Risk profile; and/or
- (c) Operational risks (including but not limited to inadequate management

of operational risk to which the Market Participant Requiring Liquid Capital is exposed).

## 15.9 OBLIGATION TO CALCULATE LIQUID CAPITAL LEVELS

**15.9.1** Subject to **Rules 15.9.2**, and **15.10**, a full calculation of the prescribed and actual Liquid Capital levels for a Market Participant Requiring Liquid Capital must be completed daily for each Trading Day (the daily liquid capital report) and supplied to NZX as part of the Market Participant Requiring Liquid Capital's required monthly return. A calculation to check that its actual Liquid Capital levels exceed the Prescribed Levels must be performed daily by a Market Participant Requiring Liquid Capital. Daily Liquid Capital calculations must be filed with NZX no later than **11.00 a.m.** or such other time as determined by NZX from time to time on each Trading Day for the close of the previous Trading Day and must be in the format of NZX FF3 Summary Report as detailed in the Guidance Notes issued from time to time by NZX. The Market Participant Requiring Liquid Capital must also maintain a log of the calculations of its actual liquid capital position.

**15.9.2** A Market Participant Requiring Liquid Capital who NZX determines, in its complete discretion, has sufficient Liquid Capital and appropriate dealing procedures to ensure that it will meet the Prescribed level at all times, may with the prior written approval of NZX, calculate its prescribed and actual Liquid Capital levels at practical and reasonable intervals (but in any case no less often than monthly). Such approval may be withdrawn by NZX at any time at its complete discretion. *(Amended 28/2/07)*

**15.9.3** Taking into account **Rule 15.6(f)**, prior to risk based adjustments being made, Securities or positions held by a Market Participant Requiring Liquid Capital must be valued at Current Market Prices for the purposes of calculating Liquid Capital.

**15.9.4** Each Market Participant Requiring Liquid Capital's daily liquid capital reports must be supported by a Principal Position Report. The Principal Position Report must be generated each morning for all open principal positions for the close of the previous Trading Day and must include for each principal position:

- (a) All Securities;

- (b) Long and short positions held by the Market Participant Requiring Liquid Capital;
- (c) Contract price; and
- (d) The mark to market value of the Market Participant Requiring Liquid Capital's principal position.

**15.9.5** Market Participants Requiring Liquid Capital must supply to NZX each month:

- (a) Trial balance summary in the format of NZX FF1 Report as provided for in the Guidance Notes as amended from time to time by NZX;
- (b) Liquidity statement in the format of NZX FF2 Report as detailed in the Guidance Notes as amended from time to time by NZX; and
- (c) Internal Control Checklist as detailed in the Guidance Notes as amended from time to time by NZX.

**15.9.6** NZX may, at its complete discretion, request in writing that a Market Participant Requiring Liquid Capital supply to NZX an intraday actual Liquid Capital position.  
*(Amended 28/2/07)*

## **15.10 APPROVAL FOR TEMPORARY NON-COMPLIANCE**

**15.10.1** **Subject to** that Market Participant Requiring Liquid Capital receiving the prior approval (subsequently confirmed in writing) of NZX, that Market Participant Requiring Liquid Capital may be temporarily excused from complying with **Rule 15.8.1** for a particular transaction. A Market Participant Requiring Liquid Capital shall not assume that approval will be given for any particular transaction or types of transactions.

*(Amended 28/2/07)*

**15.10.2** A Market Participant Requiring Liquid Capital may, upon application in writing to NZX, be excused, on such terms and conditions as NZX determines, from complying with **Rule 15.1.2**.

**15.10.3** If a Market Participant Requiring Liquid Capital is unable to comply with **Rule 15.1.2** and that Market Participant Requiring Liquid Capital has not been temporarily excused from complying pursuant to **Rules 15.10.2**, NZX

may if it sees fit, and pending any other action by NZX including possible revocation of the participant's designation as a Market Participant or, at NZX's complete discretion, declare that that Market Participant is a Defaulter, suspend the participant's designation as a Market Participant until such time as it is satisfied that the Market Participant Requiring Liquid Capital is once again in a position to comply with **Rule 15.1.2**.  
(Amended 28/2/07)

## 15.11 ESTABLISHING INTERNAL CONTROLS FOR LIQUID CAPITAL

Each Market Participant Requiring Liquid Capital must establish in-house policies and rules which control the level of business transacted to ensure that the Prescribed Level of Liquid Capital is met at all times. A Market Participant Requiring Liquid Capital shall, whenever requested by NZX, demonstrate to the satisfaction of NZX that those policies and rules are documented and working effectively. (Amended 28/2/07)

## 15.12 REQUIREMENT TO NOTIFY

Each Market Participant Requiring Liquid Capital shall notify NZX **immediately** if: (Amended 28/2/07)

- (a) There is any material change, loss or exposure, including in respect of contingent liabilities, which may affect its Liquid Capital position, whether or not it continues to maintain Liquid Capital in excess of the Prescribed Level; or
- (b) That Market Participant Requiring Liquid Capital's Liquid Capital position at any time falls below a threshold of **20%** in excess of the Prescribed Level.

## 15.13 CHECKLIST OF INTERNAL CONTROLS

As part of the internal controls required by **Rule 15.11**, all Market Participants Requiring Liquid Capital must, each month:

- (a) Complete a checklist of in-house monitoring, reconciliation and Liquid Capital Prescribed Level calculation, in the form approved by NZX as detailed in the Guidance Notes issued from time to time by NZX; and

- (b) Submit that completed checklist, signed by the Managing Principal or other person who is a current principal of a Market Participant Requiring Liquid Capital, or the Responsible Executive (whichever is appropriate) with the form approved by NZX for calculating Liquid Capital (Form FF2 as detailed in the Guidance Notes issued from time to time by NZX).