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## Disclaimer

This Guidance Note has been issued by NZX to promote market certainty and to assist Market Participants. It sets out NZX's general approach to the interpretation of the NZX Participant Rules, but is not to be regarded as a definitive statement of the application of the Rules in every situation. NZX may replace Guidance Notes at any time and a Market Participant should ensure it has the most recent version. This does not constitute legal advice. NZX recommends that Market Participants take advice from qualified persons.

# GUIDANCE NOTE GN0002/04 – TRADING ON BEHALF OF A CLIENT

## Introduction

This **Guidance Note** is published to provide guidance to Client Advising Participants in the interpretation of those NZX Participant **Rules (Rules)** that relate to trading on behalf of a client. This Guidance Note outlines NZX's expectations in relation to compliance and best practice on the part of a Client Advising Participant who is trading on behalf of a client.

Under **Section 1** of the **Rules** a Client Advising Participant is defined as:

*“Any Market Participant that provides investment advice and/or Securities recommendations to a client and may be responsible for that client’s assets at any time and includes:*

- (a) An NZX Trading and Advising Firm;
- (b) An NZX Advising Firm;
- (c) A Bank Only Participant; and
- (d) Any Approved Organisation designated as a Client Advising Participant from time to time by NZX pursuant to **Rule 3.18**”.

This **Guidance Note** should be read in conjunction with **Guidance Note GN0001/04** which provides Client Advising Participants with assistance in relation to the Know Your Client obligations of **Section 9** of the **Rules**.

In this **Guidance Note** we will cover some of the obligations that a Client Advising Participant must undertake before trading on behalf of a client including: client agreements; disclosure of interests; and putting a client order to market. It is important to note that this **Guidance Note** is not an exhaustive list of a Client Advising Participant's obligations to a client but guidance on particular obligations that NZX has received requests for clarification on.

## General Obligations – Section 9, 10 and 11

Each Client Advising Participant must ensure that if it is undertaking trading on behalf of a client that it fulfils its obligations in relation to that client's trades in accordance with the Client Advising Participant's obligations in **Sections 9, 10 and 11** of the **Rules** and any **Guidance Notes** to those **Sections**.

## Risk Warnings – Rule 11.2A

Under **Rule 11.2A** each Client Advising Participant must ensure that it provides a client with risk warnings appropriate to the type of securities and/or financial instruments that a client wishes to invest in.

*“A Client Advising Participant must provide its client with Risk Warnings each time that client requests to Trade in any Security and/or Financial Instrument that has different risks associated with it than those Securities and/or Financial Instrument for which that client has already been provided with Risk Warnings either in that client's client agreement or under this Rule 11.2A.”*

All risk warnings initially provided to a client by the Client Advising Participant should preferably be set out in the written client agreement entered into with that client. However, if that client wishes to invest in any additional securities and/or financial instruments additional to those products that that client initially invested in and for which no risk warning has previously been provided to that client, before undertaking any transaction in the relevant securities and/or financial instruments, a Client Advising Participant must advise the client of any risks associated with investing in those securities and/or financial instruments. Best practice dictates that such additional risk warnings should be in writing. NZX recommends that all Client Advising Participants record and maintain on that client's file any additional risk warnings provided to the client.

When a Client Advising Participant provides a generic disclosure in its client agreements of the general risks associated with investing in securities and/or financial instruments, Client Advising Participants must provide each client with specific risk warnings associated with the security and/or financial instrument in which a client wishes to invest to meet its obligations under **Rule 11.2A**.

If a Client Advising Participant's client agreement does not contain any risk warnings, consistent with the above, that Client Advising Participant must advise the client of the risks associated with the securities and/or financial instruments that client seeks to invest in prior to executing any trade on behalf of that client. NZX recommends that record be maintained on a client's file outlining all risk warnings given to that client.

NZX does not propose to provide an exhaustive list of all of the risk warnings associated with investing in any security or financial instrument, nor are Client Advising Participants expected to provide such an exhaustive list to its client. However, NZX does expect that, given the expertise, information and research available to a Client Advising Participant, risk warnings provide a fair and accurate disclosure of the risks likely to be associated with investing in securities or financial instruments.

## Bringing Orders to Market – Rule 11.3

**Rule 11.3** states that:

### ***11.3 BRINGING ORDERS TO MARKET***

**11.3.1** *Subject to **Rules 11.3.2, 11.3.3 and 11.3.5**, a Client Advising Participant must submit any Order, which is at market or at a fixed price limit, straight to market via the Trading System. For the avoidance of doubt pursuant to this **Rule 11.3.1** a Client Advising Participant must not, for any market or fixed price limited Order:*

- (a) Accumulate or bundle Orders coming to market;*
- (b) Delay executing client Orders; or*
- (c) Delay Orders to facilitate Crossings.*

**11.3.2** *A Client Advising Participant may, upon obtaining instructions from its client to do so (which may be by means of an e-mail, facsimile, or letter from that client or a written transcript by the Advisor for that Client Advising Participant of that client's instructions received by telephone or the inclusion of standing instructions in the client agreement in prominent lettering), execute an Order for a client at that Client Advising Participant's discretion.*

*If standing instructions are obtained via a client agreement, the client agreement must allow that client to override the standing instructions detailed in the client agreement at the time the Order is placed.*

*For the avoidance of doubt, in the absence of standing instructions obtained through the client agreement, the client instructions obtained pursuant to this **Rule 11.3.2** must be obtained for each Order and may authorise a Client Advising Participant who has obtained a client's instruction to:*

- (a) Accumulate or bundle Orders coming to market;*

- (b) *Delay executing client Orders; or*
- (c) *Delay Orders to facilitate Crossings.*

*11.3.3 Notwithstanding anything in **Rules 11.3.1** and **11.3.2** a Client Advising Participant may:*

- (a) *Accumulate or bundle Orders coming to market;*
- (b) *Delay executing client Orders; or*
- (c) *Delay Orders to facilitate Crossings,*  
*in order to participate in the sell down of:*
  - (d) *a substantial security holder's holding in a listed Issuer; or*
  - (e) *more than NZ \$5 million in value of Securities of an Issuer.*

*11.3.4 Notwithstanding anything in **Rules 11.3.1**, **11.3.2** and **11.3.3**, a Client Advising Participant must not transact and/or report Trades on behalf of its clients in order to avoid the obligations in these Rules, direction issued from time to time by NZX or contrary to Good Broking Practice.*

*11.3.5 Notwithstanding anything in **Rules 11.3.1**, **11.3.2** and **11.3.3** a Client Advising Participant may as a matter of policy in the case of Institutional Clients:*

- (a) *Accumulate or bundle Orders coming to market;*
- (b) *Delay executing client Orders; and/or*
- (c) *Delay Orders to facilitate Crossings,*

*Provided that this policy has been advised to the Institutional Client in writing and the Client Advising Participant has not received notification from the Institutional Client disagreeing with such policy or specific instructions concerning the treatment of that Institutional Clients Orders.*

The purpose of **Rule 11.3** is to ensure that requests to trade on behalf of a client are put to market in accordance with that client's instructions. The obligations of **Rule 11.3** can be met by:

1. Obtaining instructions from a client in relation to the placement of that client's order each time a client wishes to place an order with a Client Advising Participant. To meet this obligation a Client Advising Participant is required to obtain and record instructions from a client. This may be done by means of an e-mail, facsimile or letter from a client or a written transcript by the NZX Advisor of the instructions given by a client over the phone. A written transcript of a client's instruction can be a copy of an order form which clearly outlines that the client's instructions are to put the trade to market at the discretion of the NZX Advisor. In this regard a pre-printed form with boxes that can be checked would suffice; or
2. By including a term in a client agreement that all client orders will be put to market for that client at the careful discretion of the Client Advising Participant. Any such term must be legible, in bold type and must be drawn to the attention of the client prior to that client entering into that client agreement. It is important to note that any such term in a client agreement will be overridden by any additional instruction from a client about how that client would like its order put to market to the extent that it differs from the instructions outlined in the client agreement. In this regard an amendment to an existing client agreement providing the Client Advising Participant with the discretion to enter client orders would satisfy **Rule 11.3**.

For the avoidance of doubt, in a relationship between a Client Advising Participant and an Intermediary, the written authority from that Intermediary as to the placement of orders will meet the requirements of **Rule 11.3**.

It is important to note that negative consents will not meet the requirements of **Rule 11.3**.

### **Client Agreements – Rule 9.6 and Rule 9.7**

Client Advising Participants must enter in to a signed client agreement with all new and existing clients before entering a trade on behalf of a client. An existing client is deemed to be a Retail Client or Intermediary (as those terms are defined in **Section 1** of the **Rules**) who has been a client of a Client Advising Participant since **1 January 1999**. Retail Clients and Intermediaries who became clients of a Client Advising Participant **before 1 January 1999** are not required to enter into a client agreement. However, to ensure the protection of both the client and the Client Advising Participant on prudent commercial terms and to meet international standards, NZX recommends that, if reasonably practicable and as a matter of best practice, all Client Advising Participants enter into written agreements with all Retail Client and Intermediary clients.

If an existing client agreement allows for the notification of changes to the terms and conditions of an existing client agreement by specific means as outlined in that client agreement then Client Advising Participants may inform its clients of changes to terms and conditions of existing client agreements in accordance with that agreement. For example, a client agreement may specify that notification of changes to the agreement will be done within 14 days of the intended implementation of the changes and notification may be by way of a newspaper advertisement.

NZX recognises the increasing use of the internet for means of affecting commerce as allowed under the Electronic Transactions Act 2002. However, NZX is concerned about the possibility of fraud by Client Advising Participants receiving client agreements via the internet or e-mail. NZX strongly recommends that Client Advising Participants obtain all original client agreements appropriately executed in ink. For the avoidance of doubt, a Client Advising Participant may obtain a copy of an executed client agreement by fax and obtain the original copy of that client agreement at a later date.

For existing clients who already hold signed agreements, the Client Advising Participant is not required to enter into a new client agreement, but must provide the client (where appropriate) with a written update of the changes to the terms and conditions of those agreements as a result of the **Rules**.

Institutional clients are exempted from entering into a client agreement under **Rules 9.6** and **9.7**. This reflects current practice in Australia. However, NZX recommends as a matter of best practice that Client Advising Participants enter into written arrangements with institutional clients outlining both parties' obligations.

Client Advising Participants should also read **Guidance Note 0001/04** on Know Your Client for more specific information on the requirements in relation to client agreements.

### **Common Shareholder Numbers (CSN) and Trading Flags – Rule 11.4**

With the exception of the matters mentioned below, all trades on behalf of a retail client must be entered in the Trading System with that client's CSN. A flag will be provided for each of the following trades, allowing those trades to be entered into the Trading System without a CSN:

- (a) One Off Sales;
- (b) Winding Up of Estates;
- (c) Short Sales;
- (d) Institutional trades; and
- (e) Bundled orders.

The above mentioned flags will only be visible to the Client Advising Participant and NZX and will not be visible to the market in general.

Flags will also be provided for trades undertaken on behalf of a Prescribed Person or as Principal - these flags will also not be visible to the market. The flag provided for trades done at VWAP will be visible to the market.

In relation to bundled or group trades which consist of orders from, for example, Prescribed Persons and sales from the winding up of an estate, only the CSN “Multiple” will be required to enter those trades into the Trading System. The flag for a Prescribed Person will not be required in such a situation and the default flag for a Retail trade should be used.

NZX uses the trading flags to determine order flows in the market as part of its surveillance. The Dealer/DMA Dealer must ensure that the correct flags are used to indicate a trade is Principal, Wholesale or Retail.

Where the underlying clients are Retail Clients, the CSN must be used except where it is:

- (a) A One-Off Sale;
- (b) A Winding Up of an Estate, or
- (c) An order relating to Multiple Retail Clients

For the avoidance of doubt, if a client’s securities are held in a nominee account the CSN for that nominee account (not the underlying client’s CSN) is required to be entered into the Trading System.

### **Disclosure of Interests – Rules, 11.10.2, A10.3 and A10.4**

Under **Rules 11.10, A10.3 and A10.4** a Client Advising Participant must disclose:

- (a) When it is Acting as Principal in a transaction for the sale or purchase of securities prior to releasing a communication to a client;
- (b) Where there is a conflict of interest identified through the conflict management procedures required under **Rule 11.10**;
- (c) On a contract note when it is Acting as Principal in a transaction; and
- (d) On a contract note when it is acting as agent for the buyer and seller in a transaction and is earning income from both parties to that transaction.

To satisfy these **Rules**, a Client Advising Participant may make a generic statement in its client agreements (including any amendments to these) and/or contract notes that:

- (a) A Prescribed Person may or may not have an interest in a Security for which the client may or may not have an interest in;
- (b) The Client Advising Participant may or may not be Acting as Principal in a Security for which the client may or may not have an interest in; and
- (c) The Client Advising Participant may or may not be acting as agent for the buyer and seller in a transaction and may be earning income from both parties to that transaction.

It is important to note that disclosure of conflicts of interest should also be made in any research and/or disclosure documents, or statements issued by a Client Advising Participant. Generic disclosures on such documents will meet the obligations of a Client Advising Participant under these **Rules**. However, it is important to note that there may be situations when specific disclosure is required as part of the conflict management procedures required under **Rule 11.10** and/or for the purpose of Good Broking Practice. For example a Client Advising Participant must disclose on a flyer for the sale in the secondary market of debt securities for which the Client Advising Participant is acting as principal, the fact that Client Advising Participant *is* acting as principal.

It is the responsibility of the Client Advising Participant who purchases or receives research (on securities including New Zealand securities) from an external source outside of New Zealand's jurisdiction to determine what disclosures are made on that research. Best practice would dictate that some general disclosure is made on such research material indicating that the writer of the research material may or may not have an interest in the securities the subject of the research. FASTER Identification Numbers (FINs) – **Rules 11.13** and **13.16**

### **FASTER Identification Numbers (FINs) – Rules 11.13 and 13.16**

**Rule 11.13** relates specifically to the recording and storage of a client's FASTER Identification Number or FIN. Under the **Rules**, a client's FIN cannot be retained by a Client Advising Participant without written consent from that client. Any FIN retained by a Client Advising Participant must be encrypted. If a client's consent to retain its FIN cannot be obtained then that client's FIN must be destroyed at the completion of the transaction undertaken by the Client Advising Participant.

The requirements for the retention and storage of a client's FINs may be satisfied by a client entering into a written agreement with a Client Advising Participant that allows the Client Advising Participant to provide the FIN to the Trading Participant and the Trading Participant to provide it to the Delivery and Settlement Participant.

The Client Advising Participant, Trading Participant and Delivery and Settlement Participant can retain the FIN on the condition that it is encrypted and protected from unauthorised use and or access.

A written agreement between a client and a Client Advising Participant on the retention of that client's FIN must:

- (a) Detail the storage and use of that client's FIN;
- (b) Contain a client risk warning in relation to the possible consequence of unauthorised access to that client's FIN and the consequence of such unauthorised access;
- (c) Contain an acknowledgement that the Client Advising Participant will have unlimited access to the securities held by that client if that client's FIN is retained by the Client Advising Participant; and
- (d) Contain an undertaking by the Client Advising Participant that it will at all times protect that client's FIN from unauthorised use and/or access.

A Client Advising Participant may request written confirmation from a client for it to retain that client's FIN or a Client Advising Participant may include a term in its client agreement outlining that a client's FIN will be retained and encrypted unless instructed otherwise by a client. Client Advising Participants **must not** invite a client to write their FIN on their client agreement. It is important to note that if a client agreement provides for retention of a client's FIN the details outlined in **Rule 11.13.2** must also be included in that client agreement.

**Rule 13.16.4** relates specifically to the recording and storage of a client's FIN by a Delivery and Settlement Participant. Like a Client Advising Participant, a Delivery and Settlement Participant must enter into a written agreement with a client which must detail the storage and use of that client's FIN and contain an undertaking by the Delivery and Settlement Participant that it will at all times protect a client's FIN from unauthorised use and/or access. Delivery and Settlement Participants must also ensure that any FIN retained is encrypted. If consent to retain a client's FIN cannot be obtained, then that client's FIN must be destroyed at the completion of that client's transaction.

For the avoidance of doubt the completion of a trade is considered to have occurred when settlement of a transaction is completed.

If a FIN cannot be destroyed (for example if the FIN is obtained on a legal document that the Client Advising Participant must retain) **Rule 11.13.4** allows for that FIN to be retained on the condition that a Client Advising Participant establish procedures to prevent any unauthorised access of that FIN. This also applies to FINs held by Delivery and Settlement Participants.

For the avoidance of doubt, in a relationship between a Client Advising Participant and an Intermediary, the written authority from that Intermediary to retain the FIN of the underlying client or the Intermediary meets the requirement of **Rule 11.13**.

Authority to obtain a client's FIN cannot be obtained by means of negative consent. Written confirmation from that client allowing their FIN to be retained must be obtained by a Client Advising Participant. Such written consent can be obtained by means of a letter, fax or e-mail or, as indicated, by including the right to retain an encrypted client's FIN within an executed client agreement.

### Records

Pursuant to **Rule 11.12** a Client Advising Participant may keep records of a client's instructions either in paper or in electronic form. Any such records kept by a Client Advising Participant must be full and accurate and readily accessible by the Client Advising Participant. If records of a client's instructions are kept electronically those records must be immediately recallable by the Client Advising Participant.

### Non Standard NZAX Issuers and Institutional Clients

A Client Advising Participant trading for a client in any Non Standard NZAX securities is required to obtain the information from that client, and complete the checks required, under **Rule A9.2**. Institutional clients **are not** exempted from this requirement.

### Contract Notes – Rules 11.16

The purpose of **Rule 11.16** is to ensure that clients are made aware of the essential details of transactions conducted on their behalf by requiring the Client Advising Participant to send a contract note of each transaction to the clients postal address. Contract notes are not required to be sent to the clients postal address in the following circumstances:

- (a) A Hold Mail Agreement has been signed by the client (**Rule 9.5**); or
- (b) A Discretionary Account client has provided positive written consent authorising the Client Advising Participant to hold contract notes following the completion of trades (**Rule 11.16.1(b)**). This is subject to the following conditions:
  - 1. The client consent is prominent, and clearly and explicitly authorises the Market Participant to hold contract notes on behalf of the client;
  - 2. The client consent contains a notification that the client can request a contract note at any time;
  - 3. The client consent contains a notification that the client can revoke the agreement at any time;
  - 4. The client consent contains a notification that the client can request details of the costs incurred in respect of each trade on the written reports; and
  - 5. Reporting to the client is quarterly or more frequently; or
- (c) A written agreement is held by the Client Advising Participants send contract notes electronically to the client (**Rule 11.16.4**).

It is important to note that negative consent will not meet the requirements of **Rule 11.16** to send contract notes by post to the client's postal address.

All contract notes must:

- (a) Comply with Good Broking Practice (**Rule 11.16.2**);
- (b) Disclose the Delivery and Settlement Participant (**Rule 11.16.3**);

- (c) Disclose whether the Client Advising Participant is paid or will be paid by both parties to a Trade (**Rule 11.16.5(a)**);
- (d) Disclose the full extent of any commission and margin charge (**Rule 11.16.5(b)**); and
- (e) Disclose any other benefit to that Client Advising Participant or its representatives arising from the transaction (**Rule 11.16.5(c)**).

For the avoidance of doubt, the NZX Participant Rules and Guidance Notes do not replace or diminish a Client Advising Participants' statutory obligations to report to clients and the disclosures to be made including the amount of commissions and earnings from a transaction.