



NEW ZEALAND'S EXCHANGE
TE PAEHOKO O AOTEAROA

Improving Market Integrity and Liquidity

Consultation Paper

June 2019



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This Consultation Paper has been issued 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 Rules.



Introduction

NZX has been considering proposals designed to both ensure that trading volumes reported to market accurately reflect underlying market liquidity, and to aid price discovery and best execution through the central limit order book. Specifically, NZX is therefore proposing to amend the NZX Participant Rules (**Rules**) and NZX Participant Procedures (**Procedures**), as appropriate to:

- introduce a requirement for NZX Participants to report international trades (**ITR**) as a separate category to market;
- amend the minimum threshold for a Crossing under Rule 13.2.1 from \$50,000 to \$250,000; and
- require clients (other than Institutional Clients) to provide an express instruction (rather than a standing instruction) to a Client Advising Participant to permit the accumulation, bundling or delay of Orders under Rule 15.4.2.

Consultation Process

NZX is seeking responses on the proposals contained in this Consultation Paper, including the specific questions that are raised in each section of the paper.

We invite interested parties to provide their views on the proposals raised in this paper by emailing a written submission to policy@nzx.com.

The closing date for submissions is **28 June 2019**.

NZX may publish the submissions it receives so please clearly indicate in your submission if you do not wish your submission to be published, or part of your submission contains confidential information.

If you have any queries in relation to the review, please contact:

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1. International Transaction Reporting

Background

On 1 December 2017, the requirement to report international crossings was removed from the NZX Participant Rules, due to concerns that the requirement was being inconsistently applied and causing inaccurate reporting of trades to the market.

In March 2018, NZX conducted an informal consultation on the effect of the removal of international crossings from the Rules. That process highlighted concerns that the removal had resulted in reduced reporting to the market of value traded, thereby causing a negative perception of local market liquidity, particularly for dual-listed securities.

By the end of 2018 NZX observed a significant decrease of 13.1% in reported value traded compared to 2017. NZX understands that Market Participants continue to service trades previously reported as international crossings. The overall decline in reported value traded therefore suggests that the removal of international crossings has negatively affected the accuracy of the value traded that is reported to market.

Proposed introduction of ITR

As a result of these concerns, NZX is considering introducing a new International Trade (ITR) order type which will be defined separately from an Off-Market Trade, and will be required to be reported into the Trading System under Rule 10.1.5, Rule 13.1 and Procedure 2.1.2.

An International Trade (ITR) means a transaction carried out in a regulated market of a Recognised Securities Exchange (other than NZX), where:

- the transaction relates to Securities Quoted on a Securities Market operated by NZX;
- the Trading Participant receives an Order from its client;
- the Trading Participant is not Acting as Principal;
- the Trading Participant issues the contract note or confirmation of the transaction to its client; and
- the contract note or confirmation is denominated in New Zealand dollars.

Reporting ITRs

When the Trading Participant undertakes a Trade, acting as agent for the execution of a client Order with another broker on a Recognised Securities Exchange (other than NZX), it is proposed that the Trading Participant would be required to report this to the Trading System as an ITR in accordance with the Rules and Procedures.

When the Trading Participant undertakes a trade, Acting as Principal for the purposes of proprietary trading or facilitation, by purchasing or selling financial products on a Recognised Securities Exchange (other than NZX), this is not an ITR. Reporting this as an ITR would be considered to create a false or misleading appearance of active trading for the purposes of Rule 10.2.1.

Proposed inclusion of ITR in statistics

It is proposed that ITRs will be included in the statistics that NZX publishes in relation to its markets, as the Trading System does not enable this information to be either completely excluded, or for a single-side of an ITR to be excluded.

Considerations in designing the ITR requirements

In developing the proposal outlined above, NZX considered the following matters:

Certainty and consistency

One of the reasons for the removal of international crossings in 2017, was the concern that the requirements were being interpreted inconsistently, resulting in the artificial inflation of certain Trading Participant's market share statistics. The lack of consistency was perceived as unfair, particularly by smaller Market Participants who were not trading internationally.

NZX has therefore endeavoured to define ITR by reference to objective and simple criteria, to enable Market Participants to clearly understand the requirements and interpret them consistently.

Accurate reflection of market liquidity

The removal of international crossings has caused inaccurate reporting of the value traded on NZX's markets and market liquidity. Market Participants have expressed a concern that this under-reporting could cause investors (in particular overseas investors), to look to execute on international markets regardless of the relative performance. This negative perception adversely affects the ability of Trading Participants to deliver best execution on NZX's markets.

NZX considers that the introduction of the ITR requirements will aid market transparency and efficiency, by ensuring that trade value reported on NZX's markets accurately reflects trading activity which should appropriately be ascribed to the New Zealand market.

Request for submissions

NZX is seeking general comments on the ITR proposal described in this section of the Consultation Paper. In particular, NZX is seeking responses to the following questions:

1. Do you agree with the objectives of implementing requirements to report ITR? If not, why not?
2. Do you consider that the proposed definition of an ITR includes appropriate criteria to enable Market Participants to interpret the definition with certainty?
3. Do you have any comments in relation to the proposed treatment of reporting ITRs?
4. Do you have any comments on the proposed treatment of ITR in Trading Participant statistics or market statistics?
5. Are there any additional matters that should be considered in relation to the proposed ITR reporting requirements?

2. Minimum Crossing Threshold



Background

In October 2018, NZX amended NZX Participant Rule 13.2.1 to introduce a minimum threshold of \$50,000, below which a Crossing of Securities Quoted on the NZX Main Board or NZAX cannot be executed as an Off-Market Trade (unless it is a Trade with Price Improvement and at least one side of the Crossing relates to a single party).

This requirement was introduced as part of a suite of proposals that were designed to bring further Orders on-market, thereby enhancing the use of the central limit order book to enable price discovery and best execution in the longer term.

When the requirement was introduced, it was indicated that the minimum crossing size would be reviewed regularly to ensure it remained fit for purpose. NZX considers it appropriate to now re-consider whether \$50,000 is the appropriate minimum threshold for a Crossing under Rule 13.2.1.

Proposal

NZX is now proposing to increase the minimum threshold set out in Rule 13.2.1 from \$50,000 to \$250,000, below which a Crossing of Securities Quoted on the NZX Main Board cannot be executed as an Off-Market Trade (unless it is a Trade with Price Improvement, where at least one side of the Crossing relates to a single party).

NZX is not proposing any changes to the treatment of Special Crossing or Special Portfolio Crossings under the Rules.

Rationale for increasing the minimum threshold

NZX considers that the proposed increase to the minimum threshold size for Crossings is appropriate for the local market, and reflects the maturing of market practice. Since the introduction of this requirement last year, NZX has seen a significant increase in the value of securities traded on-market, with 54% traded on-market in 2018, a 27% increase on the previous year. NZX has also observed an increased demand for access to NZX's markets since its changes to improve market integrity and transparency. Therefore, NZX considers there is now sufficient support to increase the minimum crossing threshold, on the basis outlined above.

NZX has also observed a higher degree of access to NZX's markets. Therefore, NZX now considers it appropriate to increase the minimum crossing threshold, on the basis outlined above. This initiative will support NZX's intention to ensure that on-market activity in the central limit order book increases, to facilitate best execution for all clients.

The proposed increase also enables NZX to better align its settings to those that apply internationally. For example, ASIC's Australian Market Integrity Rules only permit block trades for Tier 1 Equity Market Products to be executed for transactions exceeding \$1 million.

NZX expects that, over time, as market practice evolves so that best execution is routinely achieved through the central limit order book, it may be appropriate to remove the ability to

execute Crossings without a Price Improvement (other than Special Portfolio Crossings and Special Crossings).

Request for submissions

NZX is seeking general comments on the proposal to increase the minimum threshold for Crossings. In particular, NZX is seeking responses to the following questions:

- 1 How effective is the current minimum threshold for Crossings of \$50,000 in driving Orders to be executed through the Trading System?
- 2 Do you consider that the minimum threshold for Crossings should be increased at this time? If not, why not?
- 3 Do you consider the proposal to set a minimum threshold for Crossings at \$250,000 appropriate? If not, why not?
- 4 Are there any transactions that should be excluded from the proposal, or subject to a different minimum threshold (either higher or lower)? If so, why?
- 5 Please provide any comments you may have on NZX's longer term proposal to remove the ability to execute Orders as Crossings (other than Special Portfolio Crossings and Special Crossings).

3. Bringing Orders to Market

Background

Rule 15.4.2 currently allows Client Advising Participants to accumulate, bundle and delay Orders for Retail Clients in reliance on a standing instruction contained in the client agreement.

NZX's Trading Conduct Guidance Note¹ requires that a Client Advising Participant, who exercises discretion to delay, accumulate or bundle an Order, must ensure that there is a clearly identifiable benefit to a particular client in the circumstances. NZX has identified certain instances of Client Advising Participants failing to meet this standard, and an increasing frequency of Orders being delayed. NZX is therefore considering amending Rule 15.4.2 to address these market conduct practices.

Proposal

¹ Section 4.4 of the "Trading Conduct Guidance Note" dated March 2018.



NZX is proposing amendments to Rule 15.4.2, so that a Client Advising Participant must obtain a specific and express instruction for each Order for a Client, other than an Institutional Client, (rather than relying on a single instruction that is provided through a standing instruction in a client agreement) in order to:

- (a) accumulate or bundle Orders coming to market;**
- (b) delay executing Orders; or**
- (c) delay executing Orders to facilitate Crossings.**

Client Advising Participants will continue to be able to obtain a standing instruction via the client agreement in order to accumulate, bundle or delay Orders for Institutional Clients.

No changes are proposed to Rules 15.4.3 to 15.4.5, inclusive.

NZX is proposing that a specific and express instruction be to the Client Advising Participant by a Retail or Wholesale Client, a generic instruction will therefore not be permissible. Where a Client Advising Participant obtains an instruction via electronic means, a specific “tick-box” will be required for each Order that the client permits to be accumulated, bundled or delayed.

NZX is not proposing to amend Rule 15.4.3 which allows a Client Advising Participant to accumulate, bundle or delay an Order to enable participation in either: the sell down of a substantial product holder’s holding in a listed issuer; or, the sell down of more than NZ\$5 million in value of Securities of an Issuer. NZX considers that accumulating, bundling or delaying an Order is appropriate in these circumstances, where doing so will likely result in a beneficial price the client.

NZX is not proposing to amend the requirements contained in Rule 15.4.5 relating to the accumulation, bundling or delay of Orders for Institutional Clients.

Rationale for amending the Order accumulation, bundling and delay requirements

As noted above, NZX has identified instances of market conduct where Orders have been delayed in circumstances where there was no clearly identifiable benefit to the client.

NZX considers that requiring Client Advising Participants to obtain a specific instruction from a Retail or Wholesale Client to delay, accumulate or bundle an Order, will enable these clients to have better oversight and improved transparency of the manner in which their Order is executed. This will enable Client Advising Participants to achieve Best Execution for their clients (which is relative to the instructions received from the client).

NZX considers that this proposal is consistent with the standards imposed in the Code of Professional Conduct for Financial Advice Services in relation to ethical behaviour and client care that will take effect when the Financial Services Legislation Amendment Act comes into force.

Request for submissions

NZX is seeking general comments on the proposal to require Client Advising Participants to obtain specific instructions before delaying, accumulating or bundling Orders for Retail or Wholesale Clients. In particular, NZX is seeking responses to the following questions:



1. Do you agree that the proposal to amend the requirements as to when delaying, accumulating and bundling Orders is permitted will increase market transparency and integrity?
2. Do you think that NZX's proposal would better protect the interests of clients, if not, why not?
3. Are there any other account types that should be excluded from the requirement that a Client Advising Participant obtains a direct instruction before delaying, accumulating or bundling an Order (for example: an account operated under a discretionary investment management service as defined in the Financial Advisers Act 2008 and the Financial Markets Conduct Act 2013)?
4. Are there any other considerations that NZX should be aware of in relation to the proposal to require Client Advising Participants to obtain specific client instruction, as outlined above?
5. Do you have any comments in relation to the proposal to maintain the existing requirements in Rules 15.4.3 to 15.4.5, inclusive?

