

NEW ZEALAND EXCHANGE (“NZX”) GUIDANCE NOTES

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GUIDANCE NOTES

NZX Regulations
Regulation 6.14 - "Stands in the Market – Special Order Facility"
Guidance Note Number: 02/01

1. PURPOSE

- 1.1 This document identifies the procedures NZX Firms must undertake during a stand in the market (or other bid or offer) where the Special Order Facility is used. This document should be read in conjunction with **Regulation 6.14** – “Stands in the market” and **Regulation 6.15** – “Reporting requirements for escalation clauses or other benefits in market bids”.

2. DEFINITION

- 2.1 **Special Order Facility** means the facility provided by NZX for the matching of orders using a special trading code established for that purpose.

3. INITIAL NOTICE ON CONFIDENTIAL BASIS

- 3.1 **Regulation 6.14(d)(i)**: Notice of the bid, including all relevant details, must be given to the Market Information Services section of NZX on a strictly confidential basis.

Contact details are as follows:

Telephone: 64 4 4952-810

Facsimile: 64 4 4731-470

- 3.2 **Regulation 6.14(c)**: This notice should be provided to the Manager, Market Information Services who will act as stand manager to ensure that all Regulations and procedures are followed. The stand manager will also be responsible for all communications between NZX and NZX Firms throughout the duration of the stand.
- 3.3 **Regulation 6.14(d)(ii) and Regulation 6.14(d)(iii)**: The initial notice of the stand must be kept confidential to the bidder and NZX until the process for the handling of acceptances is agreed with NZX, the stand bid is subsequently placed in the market, and the market is informed.
- 3.4 The agreement of NZX is required to the method of processing acceptances to be adopted and the form of advice to be given to the market for any use of the Special Order Facility. This is to ensure that FASTER trading and FASTER settlement can accommodate the bidder's intention and that NZX's concerns regarding the fairness of the bid to retail clients are satisfied.

- 3.5 NZX requires 24 hours advance notice of any intention to use the Special Order Facility (since arrangements may be needed for staff to handle processing) and may require the market to be advised on intended processing conditions in advance of receipt of the formal Stand Notice (even if there is uncertainty as to whether the stand will subsequently proceed).

4. INFORMATION REQUIRED BY NZX

- 4.1 **Regulation 6.14(d)(vii):** NZX Firm announcing the stand must advise of NZX the following information:

- (a) name of the Issuer;
- (b) class of Security;
- (c) number of Securities (or percentage of issued capital) to be purchased;
- (d) the price to be bid;
- (e) the period for which the stand will remain open;
- (f) details of the process of acceptance if the Special Order Facility is used; and
- (g) details of any price escalation or other conditions.

4.2 **Process of acceptance**

- (a) Where the Special Order Facility is to be used to facilitate acceptance processing, it is critical that information supplied to NZX regarding the processing of acceptances is correct, is able to be processed through FASTER settlement and is judged by NZX to be fair to retail clients. 24 hours notice of, and agreement to, 4.1(f) above is required by NZX for any use of the Special Order Facility.
- (b) NZX may require the following information to determine how the processing of acceptances will proceed:
 - (i) will normal price and time priority and matching rules apply until bid is filled or withdrawn?
 - (ii) will time priority at a fixed price apply?

- (iii) what is the method of scaling of over-acceptances if post matching processing will be used?
- (iv) are there any selective requirements for acceptance (including a requirement for the shareholder number to be provided with the sell order)?
- (v) is there any minimum acceptance required?
- (vi) is there a price escalation clause?

5. CLIENT ORDERS

5.1 Entering orders into FASTER trading

- (a) Where acceptances are to be processed after matching in the market, NZX Firm placing the special order may require other NZX Firms submitting orders to be matched, to enter the shareholder number of the client in the Broker Reference field on the order entry screen in FASTER Trading.
- (b) The shareholder number should be entered in this field and must precede, and be clearly separate from, any other information recorded in this field, such as the client adviser code/initials for example.

5.2 Shareholder number validation

- (a) NZX will validate the shareholder number with the share registrar for the security and confirm the client's holding. This is particularly relevant where a stand in the market allocation process is targeted at 'retail' shareholders.
- (b) If an incorrect shareholder number is provided, no shareholder number is provided, or it is for more than 5% above the security available, the order will be cancelled. Otherwise it will be left or scaled to the lesser of the order or to the security available. If the shareholder attempts to sell more shares than the maximum number allowed under the stand, the order will be cancelled.
- (c) This process enables selective processing of matched orders to ensure small shareholders can participate and to avoid 'gaming' of the order through short selling and principal trading.
- (d) Trades that are matched in the Special Order Facility in order to facilitate acceptance processing are not confirmed Trades until NZX has completed any selective processing.

- (e) Any scaling or adjustment of a trade is effected by cancelling the initial trade and creating a new trade with the same details.
- (f) A Client Outward Transfer (COT) should not be performed by the Seller until confirmation from NZX is received that Trades have been confirmed. Doing so may invalidate otherwise legitimate acceptances when the holding is checked for available balance.

5.3 **Nominee Accounts**

- (a) In order to accommodate those shareholders using broker nominee accounts, NZX Firms must first lodge an acceptance under the Special Order Facility for each nominee holder using the CSN of the nominee holder. (Note this requires all nominee account holders to have a CSN).
- (b) This will prevent multiple applications through more than one Nominee Account. NZX Firms must then provide to NZX a file containing the following information for each nominee holder selling into the stand:
 - (i) NZX contract number for the matched acceptance (of the format yyyynnnnnnnnn);
 - (ii) Common Shareholder Number of the nominee account holder;
 - (iii) name of shareholder; and
 - (iv) balance held under the nominee holding.
- (c) The information must be provided to NZX following the conclusion of the stand prior to 4.00pm on the final day of the stand. This information will override any information originally specified when the order was entered into FASTER Trading.
- (d) **This file must be provided to NZX in either an Excel or csv format and should be attached to an e-mail addressed to <faster@nzx.com>.**
- (e) An example of the spreadsheet is available from NZX if required (email: nzx@nzx.com).
- (f) Trades marked as nominee Trades will be removed from the allocation process where the nominee details are incorrect – for example, they are not uniquely qualified or do not contain a holding or balance.

6. TIMING

- 6.1 **Regulation 6.14(d)(v):** A stand in the market where the Special Order Facility is being used to facilitate acceptance processing requires one hour's final notice of price, quantity and security code to NZX. This provides NZX with sufficient time to communicate to the market and for NZX Firms to establish the appropriate internal procedures for management of their client orders.
- 6.2 **Regulation 6.14(d)(xii):** When the Special Order Facility is to be used, then the opening of the security used to facilitate the stand in the market is at the discretion of NZX. In making this decision, the Stand Manager will consider the following:
- (a) the size of the stand and its potential impact on the normal market opening; and
 - (b) whether or not the market is sufficiently informed of the processes to be undertaken in regard to acceptance procedures.
- 6.3 Unless special reasons apply, stands in the Special Order Facility will not open before 10:00am or close after 3:00pm on a trading day.

7. MARKET OPERATIONS PROCEDURES

7.1 FASTER Trading: Regulation 6.14(d)(xi)

- (a) On receipt of notice, if the bid is to be processed in the Special Order Facility, then NZX will proceed to establish a separate market for the security in FASTER.
- (b) Several temporary 'special' codes exist in FASTER trading on the Specials Board for this purpose namely SPEC1, SPEC2 and SPEC3.
- (c) Notification to the market of temporary trading code and board will be disseminated by Market Operations via FASTER Trading 'Messages', email to NZX Firms' predetermined addresses for this purpose, and by facsimile to FASTER Dealers and FASTER Transfer Clerks. This will occur shortly after the official announcement of the stand has been released to the market.
- (d) NZX Firms are responsible for providing a generic email address to Market Control for this purpose e.g. <trading@abca.co.nz>.
- (e) For a stand in the market that is not subject to any conditions and where NZX Firm bidding can establish priority in the market at the

nominated bid price, then a separate code on the Specials Board is not required as the stand can be conducted under the usual trading code for the security.

7.2 FASTER Settlement

- (a) In addition to the trading code established in FASTER Trading, a FASTER settlement code will also be created by the Stand Manager. This code will be the Issuer Code, plus a suffix of Z, Y or X depending on availability. Trades executed in the Special Board will be mapped by Market Information Systems staff to this code prior to processing acceptances. Details of this code will be communicated to settlement departments.
- (b) This FASTER settlement code will have a quotation basis of "XX" where the Special Order Facility is to be used to facilitate acceptance processing. This means that this is a reported transaction subject to change due to acceptance processing or price escalation. The impact on settlement for NZX Firms is that matched Trades will be reported to NZX Firms' systems, but NZX Firms will be unable to lodge a Claim of Delivery until special processing has been completed and the XX status has been lifted from the Trades.
- (c) The special processing of these transactions will have the following outcomes:
 - (i) unaffected Trades will stand with the trade date equal to the trade execution date;
 - (ii) Trades that require adjustment will be cancelled. The cancellation date will be equal to the special processing date; and
 - (iii) new Trades, reflecting the adjustments made will be created with a trade date that is equal the special processing date.

7.3 Conclusion of the Stand

- (a) On advice from NZX Firm that the stand has been completed, the temporary trading code will be placed in Enquiry in FASTER Trading by the Stand Manager.
- (b) Notification of this event must be communicated to the market in accordance with the procedures for processing market announcements.

8. RESPONSIBILITIES OF THE ORGANISING BROKER

- 8.1 **Regulation 6.14(d)(xiv):** If the Special Order Facility is used, then only NZX Firm acting for the stand may place a bid order in the separate market established for the security.
- 8.2 **Regulation 6.14(d)(xv):** NZX requires that this bid be maintained until the instruction is completed or until notice is given to NZX by NZX Firm announcing the stand that the bid is withdrawn.
- 8.3 **Regulation 6.14(d)(xvi):** On advice from NZX Firm that the stand has been completed, closed or withdrawn, then an announcement to that effect must be made to NZX for dissemination to the market. Such notification must include detail on the level of acceptances.

9. RESPONSIBILITIES OF NZX FIRMS

- 9.1 **Regulation 6.14(d)(xvii):** When notice of a bid has been given, bids at other prices may be made by any person, including the original bidder, in the usual trading code for the security.
- 9.2 **Contract notes:**
 - (a) In a stand in the market where conditions are attached to the bid, NZX Firms accepting the bid for clients should note on contract notes with clients that the transaction is subject to the terms of the offer or similar wording.
 - (b) For Trades matched in the Special Order Facility under the quotation basis of "XX", it should be noted that these are not confirmed Trades until notification from NZX has been received advising that they have been confirmed.
 - (c) This advice will be given by the Stand Manager following the completion of acceptance processing by Market Information Systems staff.

NZX REGULATIONS

Regulation 4 - "Client Orders"

Guidance Note Number: 01/01

1. MINIMUM REQUIREMENT FOR INFORMATION FROM CLIENTS

- 1.1 **Regulation 4.1(b)** outlines the minimum information that must be recorded by all NZX Firms prior to any business being transacted with, or for, any person.
- 1.2 **Regulation 4.1(b)(vii)** provides for circumstances where a client is unwilling to provide information or, where an NZX Firm may be in a position to vouch for a client due to a long association with that client. This provision should not be used by NZX Firms to avoid their obligations to record the minimum information required from clients under this Regulation.
- 1.3 **Purpose:** The purpose of minimum information requirements is to provide an additional layer of protection for the investing public against the possible fraudulent sale of Securities.
- 1.4 **Requirement for Date of Birth:** Under the requirement to provide date of birth information in **Regulation 4.1(b)(vii)(cc)**, NZX Firms may sight any number of documents containing that information in order to verify the identity of the client.
- 1.5 **Requirement for IRD Number:**
- (a) NZX acknowledges that from time to time there may be clients who are unable to provide NZX Firm with a New Zealand IRD number, including (by way of example only) some overseas based clients and minors. In all other circumstances, the requirement to record the IRD number is mandatory.
 - (b) Providing a client's IRD number provides NZX and the share registry with a valuable tool to ascertain the uniqueness of an individual, and avoids duplicating holdings on the register.
- 1.6 **Regulation 4.1(e):**
- (a) NZX Firms should note that:
 - (i) reference to "person" in this Regulation refers to the intermediary;

- (ii) if the intermediary is not an "Investment Adviser" then the Mandatory Disclosure Document would not be required.
- (b) In regard to **Regulation 4.1(e)(viii)**, while NZX encourages NZX Firms to obtain a CSN on behalf of their clients, if a CSN is not available then NZX Firms should use their discretion.

2. DATABASE

- 2.1 NZX Firms should have a database that is easily available to all employees and representatives of NZX Firm who are authorised to provide Security recommendations.
- 2.2 Such records should include all information necessary for use by employees and representatives when providing advice and services to clients in terms of the Code of Practice.
- 2.3 The database may be in either an electronic or paper based form or a combination of both.
- 2.4 Procedures should be established by NZX Firm to allow for the easy updating of client information.
- 2.5 The database of NZX Firm should seek, and where provided by the client, record the following information as appropriate in individual circumstances for each client where NZX Firm will be providing investment advice and Securities recommendations:
 - (a) name and title;
 - (b) home address;
 - (c) mailing address (if different);
 - (d) Common Shareholder Number (CSN);
 - (e) occupation;
 - (f) employer;
 - (g) position;
 - (h) does client own home?;
 - (i) superannuation arrangements;

- (j) family structure and dependants;
- (k) marginal tax rate;
- (l) other taxation considerations;
- (m) funds available for investment;
- (n) current level of liquidity;
- (o) level of debt/extent to which the client is geared;
- (p) special future requirements for cash;
- (q) experience with investment in the stockmarket;
- (r) investment objectives;
- (s) personal investment interests and preferences;
- (t) current portfolio;
- (u) attitude to risk;
- (v) if a company, the copy of the Board resolution allowing the holding of Securities;
- (w) bank account details and settlement arrangements;
- (x) IRD number;
- (y) either:
 - (i) passport number;
 - (ii) drivers licence number; or
 - (iii) date of birth.

2.6 NZX Firms should note that where a client is a Professional Investor, the above information does not need to be requested.

2.7 NZX recommends that a CSN should be applied for, or recorded, even if the client does not currently hold any New Zealand Securities. The allocation of a CSN gives assurance that Know Your Client procedures have been undertaken.

3. PRIVACY ACT 1993

- 3.1 In terms of the Privacy Act 1993, NZX Firms should take care when requesting information from clients that they advise of the reasons for collecting or requiring such information.
- 3.2 In terms of the information required under **Regulation 4.1(b)**, NZX requires NZX Firms to record this information in order that the client's identity is confirmed to protect the client against unauthorised purchases or sales.

4. NEW CLIENT PROCEDURES

- 4.1 In addition to the requirements of **Regulation 13.1(h)**, NZX suggests the following policies and procedures for adoption by NZX Firms:
 - (a) separate the function of account opening and verification so as to ensure that the same person does not provide and verify client information;
 - (b) ensure a written record is kept which shows for each new client and account that is opened, the verification that was conducted of the client's information;
 - (c) do not accept the first order from a new client unless all client information is obtained and verified;
 - (d) additional enquiries should be made where the new client:
 - (i) is reluctant to provide information about themselves;
 - (ii) wishes to conduct business in cash;
 - (iii) has address that is a post office box;
 - (iv) may be a minor, bankrupt or other person or entity which does not have the capacity to transact business on his, her or its own account.

5. VERIFYING INFORMATION

- 5.1 It is also recommended that client identity be verified using information obtained from at least two different sources.

6. ONE-OFF TRANSACTIONS

6.1 Minimum information as required under **Regulation 4.1** must be collected prior to transacting any business with or for any person. NZX Firms must be careful to ensure that they can establish the identity of a seller prior to any transaction in order to prevent a potential fraud occurring.

7. OTHER REGULATION

7.1 NZX Firms are reminded that the following Regulations also apply to their dealings with clients:

- (a) **Regulation 2.1:** Disclosure of Interest
- (b) **Regulation 2.2:** Acting as Principal
- (c) **Regulation 2.3:** Duty of Care
- (d) **Regulation 6.19:** Client Orders Precedence

7.2 **Regulation 4.2:Discretionary Accounts:**

- (a) Given the potential for Discretionary Accounts to be abused (e.g. excess trading, selection of investments that are unsuitable to a particular client), it is important for NZX Firms to ensure that persons operating Discretionary Accounts are adequately supervised. As such, a sufficiently senior person within NZX Firm or the nominated Compliance Officer, not involved in the operation of the relevant Discretionary Account, should review the account's operation on a semi-annual basis.
- (b) Attention is also drawn to the requirements of **Regulation 13.1(g)** which requires NZX Firms when managing portfolios under absolute authority to have such authority in writing ready to produce on request for the Inspector.

7.3 **Regulation 4.3:Controls and procedures**

- (a) **Representatives:** The term **Representative** includes NZX Brokers and NZX Associate Brokers.
- (b) **Compliance Officers:** The Compliance Officer's role is to identify and report to the Managing Principal any suspected breaches of NZX Firm's internal procedures and policies, in addition to ensuring compliance with the Business Rules, Regulations and Code of Practice and any other statutory reporting requirements.
- (c) **Compliance and Procedure Manuals:** In terms of **Regulation 4.3(b)**, compliance and procedure manuals should be supplied to

employees and representatives as they relate to their responsibilities within NZX Firm. Such manuals may be provided electronically.

(d) **Re-performance checks:**

- (i) Under **Regulation 4.3(d)**, NZX recommends that re-performance checks be carried out annually by NZX Firms. Such checks should aim to ensure that established controls and procedures regarding the receipt of orders, execution of trades and the settlement of transactions are effective. In addition, re-performance checks should include compliance with NZX Business Rules, Regulations and Code of Practice and any relevant statutory requirement in relation to NZX Firm's business.
- (ii) Ideally, NZX recommends that a random sample of orders from each order taker be selected for re-performance checking in an attempt to isolate any issues with control or procedure.

7.4 **Regulation 4.4: Staff training**

- (a) NZX Firms should ensure that staff training covers induction training for new representatives and employees and all material aspects of the work in which representatives and employees will be engaged.
- (b) Attention is drawn to Rule 3.14 of Part A of the Business Rules which requires each NZX Firm to ensure that all of its employees, officers, agents and principals who are acting as client advisers and/or investment advisers are NZX Associate Brokers.
- (c) Conduct by a staff member of an NZX Firm that contravenes the Regulations may expose NZX Firm to disciplinary action. It is in the best interests of NZX Firms to ensure that staff are adequately trained in respect of both the Business Rules, the Regulations and the Code of Conduct and are properly supervised.
- (d) NZX Firms should pay particular attention to:
 - (i) supervision of branch offices;
 - (ii) background checks of new employees;
 - (iii) monitoring authorisation for staff orders, including those for senior staff; and

- (iv) reporting by compliance staff.

7.5 **Current copies of the Business Rules, Regulations and Code of Practice are available on NZX's website: www.nzx.com**

7.6 **Regulation 4.5: Client trading**

- (a) All representatives and employees of NZX Firms dealing with external clients should have easy access to the Gazette Notice Insider Trading (Approved Procedure for Company Officers) Notice 1996, and be provided with training as to its interpretation and application.
- (b) NZX Firms that suspect that the market for a security may be uninformed or that trading in a security is unusual, are encouraged to raise their concerns with the Market Information Services Department at NZX. Contact Mary Meyers 64 4 4952-810.

7.7 **Regulation 4.6: Trading by Representatives and Employees:**

- (a) In accordance with the Code of Practice, NZX Firms should seek to avoid conflicts of interest where possible. When conflicts do arise, NZX Firms should disclose these fully to any persons dealing with NZX Firm on matters which are the subject of conflict.
- (b) NZX Firm must maintain a register of all Quoted Securities in which a Relevant Interest is held by NZX Firm, its representatives or employees to allow NZX Firm to identify potential areas of conflict between NZX Firm's activities and those of its representatives and employees and to allow Compliance Officers to check to ensure that appropriate disclosures are being made to clients;
- (c) It is not NZX's intention that advisers supply clients with a copy of the register of Quoted Securities held by them.

7.8 **Regulation 4.8: Recording of client instructions**

- (a) NZX Firms are encouraged to use voice recording systems where orders are taken over the telephone in order to corroborate, check and verify advice given and instructions received in order to the integrity of order taking.
- (b) The length of time that tapes of client instructions are retained is up to each NZX Firm and will depend on the recording system used and the ability to retrieve information. NZX recommends

that such tapes be kept for a minimum of 30 days, or longer in the case of any known dispute.

- (c) NZX recognises that NZX Firms may have branch offices not under the direct supervision of a Compliance Officer. In such cases, the Compliance Officer may delegate the supervision of access to voice recording tapes to a suitable person on a case by case basis. Such authority may only be delegated to a person who has not been involved in the circumstances leading to the tape's review.

ORDER NUMBERS

- 7.9 **Regulation 4.8(b)(iv):** requires that orders be uniquely numbered. NZX Firms should note that where their internal systems automatically allocate a unique number for order reference that number is sufficient for the purposes of compliance with this Regulation.

FORMS