



NEW ZEALAND'S EXCHANGE
TE PAEHOKO O AOTEAROA

NZ Markets Disciplinary Tribunal Rules Review

Consultation Paper

November 2021

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This Consultation Paper has been prepared 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 NZ Markets Disciplinary Tribunal Rules.

Introduction

The NZ Markets Disciplinary Tribunal (**Tribunal**) is an independent adjudicative body, whose principal role is to determine whether an issuer or market participant has breached the rules relating to the operation of NZX's markets¹, in any matter referred to it by NZ RegCo.

NZX has been considering certain settings contained in the NZ Markets Disciplinary Tribunal Rules (**Rules**) to ensure that they remain fit for purpose by providing appropriate support to the regulatory and enforcement outcomes sought by NZ RegCo, as there has not been a holistic review of the Rules since their implementation in 2009². As part of that review, NZX and NZ RegCo engaged with the Tribunal who identified certain issues arising under the current Rules and NZ Markets Disciplinary Tribunal Procedures (**Procedures**).

As a consequence of the review, NZX has developed a suite of proposals that are the subject of this consultation paper. The proposals relate to:

- Membership of the Tribunal (**Membership Proposal**);
- the Tribunal appeals' provisions (**Appeals Proposal**); and
- the Tribunal penalties assessment process and framework (**Penalties Regime Proposal**).

Consultation Process

NZX wishes to consult on the proposed amendments that are contained in the accompanying exposure drafts of the Rules and Procedures.

We invite interested parties to provide their views on the proposed amendments by emailing a written submission to policy@nzx.com. The closing date for submissions is **25 February 2022**.

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

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

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¹ These rules are the NZX Markets Rules (the Listing Rules, the NZX Participant Rules, the Derivatives Market Rules and any other rules and regulations of any other NZX Market and/or of NZX from time to time and as amended by NZX from time to time) and the Clearing and Settlement Rules and Depository Operating Rules.

²Other than the thematic review of the Tribunal penalties regime in 2015/2016

Membership Proposal

NZX is proposing amendments to the composition and tenure requirements for the Tribunal that are contained in the Rules.

These amendments are intended to enable the more efficient operation of the Tribunal, to support NZX's licensed market operator obligation to ensure that it has adequate arrangements for enforcing compliance with NZX's market rules, including by having a sufficiently independent adjudicative body.

Composition

Under the current membership framework contained in the Rules, the Tribunal has a number of prescribed member categories, as follows:

- Legal Appointees: being current or former barristers and/or solicitors with at least 10 years' legal experience (minimum two);
- Market Participant Appointees: being current employees or directors of a Market Participant, and at least one of a Trading Participant (minimum three);
- Clearing Participant Appointees: being a person with experience with a current or former Clearing Participant (minimum one);
- Derivatives Participant Appointees: being a current or former employee of a current or former Derivatives Participant (minimum one);
- Issuer Appointees: being a current company director of a listed Issuer (minimum two); and
- Public Appointees: being people with reputation and demonstrated knowledge and expertise in relation to markets (maximum 11).

The Clearing Participant and Derivatives Participant categories were created in 2010, when NZX commenced its role as a central-counterparty clearing house (via NZX Clearing) and established the NZX dairy derivatives market.

NZX and NZ RegCo, in consultation with the Tribunal, have identified a number of issues in relation to the current composition requirements of the Tribunal, and as a result has identified a suite of proposed amendments which are described further below. The proposed amendments are contained in proposed Rule 2.1.1 and seek to:

- consolidate the Tribunal membership categories by removing the Public Appointee category, Derivatives Appointee category and Clearing Appointee category;
- change the eligibility criteria for the Issuer Appointee category and Market Participant Appointee category; and
- change the number of members in each Appointee category.

Consolidate membership categories

The current membership appointee categories unnecessarily fragment the composition of the Tribunal, and do not reflect the focus of the work of the Tribunal (which relates to determining conduct matters arising out of the market rules that apply to listed Issuers and accredited Participants) and the legal process support and rigour which is important for the Tribunal.

It is proposed that the Tribunal membership be consolidated around three categories (Legal Appointees, Issuer Appointees and Market Participant Appointees).

A consequence of these amendments is that the Public Appointee category would be removed. NZX considers that there is limited understanding of this category, and past appointees have often been placed into this category because they are not technically eligible under other categories, although they would have more naturally come within one of the Legal Appointee, Issuer Appointee or Market Participant categories. NZX also considers that it is appropriate to remove the Public Appointee category, as unlike other disciplinary tribunals that include lay person members, the Tribunal does not hear matters referred to it by the public. The Tribunal's mandate is solely to hear matters referred to it by NZ RegCo. NZX therefore considers that there is no need for a Public Appointee to be a constituent member of any Tribunal division (and it is noted that this is not currently a requirement).

In addition, the Derivatives Participant Appointee category would be removed. NZX considers that the key areas of expertise relevant to potential breaches of the Derivatives Market Rules (client assets, orderly markets, trading conduct, capital adequacy, etc.) are not unique to the Derivatives Market Rules. These are concepts that are common across all of the NZX market rules that apply to Participants, and potential breaches of these requirements could be appropriately considered by a Market Participant Appointee. We also note that there has only been one matter referred to the Tribunal under the Derivatives Market Rules since 2015, and that in the near term the proposed transfer of the dairy derivatives contract suite to SGX will further reduce trading activity on the NZX Derivatives Market.

The proposed streamlining of the Tribunal membership categories, would also see the removal of the Clearing Participant Appointee category. Similar to the position in relation to potential breaches of the Derivatives Market Rules, NZX considers that the core capital adequacy provisions of the Clearing & Settlement Rules are fundamentally consistent with those that apply under the NZX Participant Rules and could be appropriately considered by a member within the Market Participant Appointee category. In addition, the Clearing & Settlement Rules and the Depository Operating Rules and Procedures contain number of technical/operational requirements for clearing, settlement, and depository transactions that apply as matters of strict liability that do not require specialist consideration by a Clearing Participant Appointee member.

In addition, NZX notes that the Clearing Participant Appointee and Derivatives Participant Appointee membership categories create an unnecessary key person risk to the ability for the Tribunal to operate in accordance with the Rules, if a member within one of those categories resigns.

[Change the eligibility criteria for Issuer Appointees](#)

NZX considers that the current eligibility criteria across membership categories are inconsistent and artificially constrain eligibility of new and existing members. In particular:

- only current company directors are eligible as Issuer Appointees; and
- only current employees and directors are eligible as a Market Participant Appointee (although former employees and directors are eligible as Clearing or Derivatives Participant Appointees).

The effect of these requirements is that number of candidates that might be viable for Tribunal membership are ineligible, which artificially restricts the candidate pool. In addition, Tribunal

members who have a change in circumstances (for example, ceasing a role, or there being a change in the status of their employer) may find themselves ineligible to continue membership.

NZX therefore proposes that the eligibility criteria that apply to Issuer Appointees is amended to include current or former directors or officers of a current or former Issuer. NZX also proposes that the eligibility criteria for membership of the Market Participant Appointee category be amended to include current or former employees of a current or former Market Participant, so long as at least two Tribunal members are current or former employees of a current or former Trading Participant.

[Change the number of members in each Appointee category](#)

In support of the proposals to streamline the Tribunal member categories, NZX is proposing changes to the required number of Tribunal members within each category. Specifically, NZX is proposing that the Tribunal is comprised of at least five members in each of the Issuer, Market Participant and Legal Appointee category.

NZX considers that this proposal will enable the Tribunal to more efficiently manage its composition requirements, while providing an appropriate level of membership diversity to consider matters referred to the Tribunal by NZ RegCo.

Tenure

Currently the Rules require that members are appointed for a term of up to three years, with a maximum of three consecutive terms, and that NZX will periodically call for nominations for appointment. This has resulted in the concentration of member appointments and retirements, due to previous appointment “cycles”, meaning that the Tribunal frequently has a significant number of members who retire at the same time (including significant retirements to occur in 2022).

The effect of this changing composition cycle means that the Tribunal periodically loses significant institutional knowledge among its membership, as a large cohort of new members are appointed. This is exacerbated by those retirements often being concentrated in a specific Appointee category.

In addition to the knowledge retention risk described above, NZX considers that the administration involved in adhering to the tenure requirements, is disproportionate to the workload of Tribunal members.

NZX is therefore proposing changing the default term for each Tribunal member to a period of up to five years, with a possible extension of a further five year term. This proposal would reduce the administration associated with the rollover process for existing members, and ensure members have a slightly longer period on the Tribunal, increasing the opportunity to participate in hearings.

Public nominations process

Currently Rule 2.1.4 anticipates that NZX will periodically call for nominations for appointment. NZX is then empowered to appoint candidates to become members of the Tribunal, subject to confirmation by the FMA.

NZX notes that the public nominations process has historically primarily focused on the nomination of Public Appointee members, which NZX is proposing to remove as part of its proposal to streamline the Tribunal's composition requirements. As noted above, one of the reasons for the proposed removal of the Public Appointee member category is that the Tribunal does not directly hear matters referred to it by the public unlike the work of other disciplinary tribunals, such as the Lawyers and Conveyancers Disciplinary Tribunal and the Health Practitioners Disciplinary Tribunal.

In addition, the public nominations process has been infrequently used in practice. No public nominations have been sought since 2013. This reflects that appointments since that time have been made to fill specific vacancies in the Tribunal's membership.

NZX is therefore proposing to remove the public nominations process from the Rules, because the process is ineffective, imposes a disproportionate administrative burden on NZX and is infrequently used in practice. NZX considers that the removal of the public nominations process will not negatively affect the ability for the Tribunal to be comprised of appropriately qualified and diverse members.

Appeals Proposal

Section 7 of the Rules includes provisions dealing with the ability for a party to appeal the Tribunal's determination. In light of the fact that these provisions are seldom used, with only two appeals undertaken in the last ten years, NZX and NZ RegCo have engaged with the Tribunal in relation to the current appeals settings, and identified a number of proposed amendments to the appeal settings which are described further below.

The proposed amendments are described further below and seek to:

- clarify the scope of the appeal provisions;
- clarify the scope of the hearing provisions, including the right to a virtual oral hearing; and
- clarify the ability for a party to adduce new evidence in respect of an appeal.

NZX considers that these amendments will support its obligations to have sufficient arrangements to enforce compliance with its rules, by providing greater clarity for parties to a disciplinary matter as to the appeal and hearing process.

Scope of an Appeal

NZX considers that the Rules do not currently provide sufficient clarity or consistency on the scope of the right to appeal, and that as a result, the Rules include a number of provisions that could be interpreted to enable a broader right of appeal than is intended.

NZX is proposing amendments to the Rules to clarify the limited right of appeal in relation to Tribunal determinations and Infringement Notice determinations. These amendments are contained in Rule 7.1.1 and are intended to clarify that an Appeal operates as a review of a determination, rather than a new hearing of the relevant breach.

Oral hearing requirements

NZX considers that the Rules do not provide sufficient clarity of the ability for a party to request an oral hearing, including due to several internal inconsistencies within the Rules. These inconsistencies relate to the provisions that describe oral hearings as a mechanism to establish the facts of a case, which does not align with the application of the right to appeal determinations, that is permitted by other provisions within the Rules.

NZX is therefore proposing to amend the Rules to allow any party to an appeal, to request an oral hearing without reference to the determination of facts, and provide that where a party to an appeal seeks an oral hearing, an oral hearing will be held (subject to a bad faith exception).

In addition, the Rules do not currently provide for virtual oral appeal hearings, as they require that oral hearings are held with all parties physically in the same place. This restriction does not align with evolving legal practice, which enables greater use of technology and virtual meetings and hearings.

NZX is therefore proposing to give the relevant Chair an explicit power to order an oral hearing of an appeal in the absence of any request from the parties and enable oral hearings to be held virtually.

[Adducing new evidence](#)

The Rules currently lack clarity on the ability of a party to adduce new evidence in any appeal hearing and are inconsistent in the approach to the submission of new evidence, relative to the limited right of appeal.

NZX is therefore proposing to amend the Rules to permit a party to an appeal to apply for leave to submit new evidence. New evidence would be permissible if it is credible and relevant to the issue in the appeal and if it could not, with reasonable diligence, have been discovered prior to the initial hearing.

Penalties Regime Proposal

Under the Rules, the Tribunal can currently impose a range of sanctions if it finds a breach of NZX's market rules relating to the operation of NZX's markets. The Rules and Procedures also contain provisions defining how the Tribunal should assess conduct, and determine the amount of any financial penalty under the Rules.

As a result of the review of the Rule settings, both NZ RegCo and the Tribunal have identified amendments that would bring the penalty assessment into line with a more orthodox approach that is currently used by other disciplinary bodies. NZX considers that the changes will enable a more appropriate calibration of financial penalties to the adverse effect of the conduct on NZX's markets.

The amendments which are being proposed, and are described further below, would:

- revise the penalty assessment methodology applied by the Tribunal when making penalty determinations; and
- alter the penalty bands contained in the Procedures.

Penalty assessment methodology

The Procedures currently provide for conduct to be assessed in one stage by reference to various penalty band factors, which cover both the breach and the Respondent itself. The initial penalty that is identified as a result of that review is then adjusted by reference to significant aggravating and/or mitigating factors not otherwise provided for by the Procedures.

This approach to the assessment of financial penalties, departs from orthodox practice in relation to the assessment methodology for determining the level of a financial penalty, that is commonly used by disciplinary agencies. NZX is proposing amendments to the methodology to better align with standard disciplinary considerations, by implementing a framework whereby the following steps are used to assess a financial penalty:

- Step 1: an adjusted starting point is determined for the breach as if the conduct had been subject to a defended hearing, which incorporates all relevant aggravating and mitigating features of the breach, then
- Step 2: the aggravating and mitigating features of the Respondent are then considered.

NZX considers that this approach will enable the Tribunal to more effectively attribute appropriate financial penalties to misconduct affecting NZX's markets.

As part of the recalibration of the penalty assessment methodology, we have reconsidered the factors that are currently set out in the table in Procedure 9.2.2, that may be taken into account by the Tribunal when determining the appropriate penalty. As a result of that review, we are proposing more specific factors that may be considered by the Tribunal as part of the Step 2 assessment process as either aggravating factors that should increase the penalty from the original starting point or mitigating factors that should lower the penalty from that assessed under Step 1. These factors are now included in Procedures 9.2.5 and 9.2.6.

Penalty band structure

Currently the Procedures contain three penalty bands that apply to different types of breaches, as follows:

- Penalty Band 1: a fine of between \$0 and \$20,000 for minor breaches;
- Penalty Band 2: a fine of between \$0 and \$200,000 for moderate breaches; and
- Penalty Band 3: a fine of between \$0 and \$500,000 for serious breaches.

The structure of these penalty bands again departs from orthodox practice, because the bands start at \$0, and the penalty band acts as an “end point” for the potential penalty. NZX understands that it is more common for disciplinary regimes to have overlapping and cascading penalty bands, set by reference to the relative seriousness of the breach, which act as “starting points”, subject to subsequent assessment of the Respondent under the second step of the two-step test penalty assessment test (discussed above).

NZX is therefore proposing to amend the Procedures to provide for overlapping, “starting point” penalty bands. In applying the revised penalty bands, the Tribunal will consider a range of factors relating to the breach to determine the starting penalty band and starting point penalty within that penalty band, as part of the proposed Step 1 of the penalty assessment process.

The application of the two-step process which then requires the Tribunal to consider the aggravating and mitigating factors relevant to the Respondent, may in certain circumstances result in penalties being determined by the Tribunal that are outside of the range of the relevant starting penalty band. We have clarified within the Procedure 9.2.1 that the ultimate financial penalty for the breach that is determined by the Tribunal may fall outside of the starting point penalty band that is initially identified by the Tribunal when considering the breach.

NZX expects that the proposed ‘two step’ penalty assessment methodology that sees the determination of a starting point penalty after the consideration of factors relating to the breach, followed by the step 2 consideration of the aggravating and mitigating factors relating to the Respondent, coupled with the formulation of overlapping penalty bands will provide a regime that enhances the Tribunal’s ability to determine penalties for breaches of the Rules.

NZX is also proposing amendments to the nature of conduct that would fall within penalty band 3, to narrow the nature of breaches that would fall within that penalty band to more serious breaches of the Rules. Penalty band 3 therefore no longer applies to breaches of ‘fundamental obligations’ under the relevant Rules. As a result, breaches of Rules reflecting fundamental obligations (for example: the corporate governance and continuous disclosure provisions of the Listing Rules) will not necessarily result in a starting point assessment that penalty band 3 applies to the breach, unless the Tribunal considers that the breach has the factors referred to in the Procedures that make it appropriate for the misconduct to fall within the penalty band (for example: because it is a serious breach with significant consequences).

The suggested starting penalty band ranges are:

- Penalty Band 1: \$0 - \$40,000
- Penalty Band 2: \$30,000 - \$250,000
- Penalty Band 3: \$200,000 - \$500,00

NZX considers that these amendments will create a more fit for purpose regime, that will improve the disciplinary outcomes for NZX’s markets.

Financial capacity of the Respondent

As part of our reconsideration of the factors relating to the Respondent that should be considered as part of the Step 2 assessment process, NZX has been considering the extent to which the financial capacity of a Respondent should operate as an aggravating or mitigating factor that increases or lower the level of Penalty assessed under Step 1.

Financial capacity is not currently listed within the Procedures as a consideration that is directly considered by the Tribunal when making a penalty determination, although it may be considered indirectly, for example: whether an Issuer had adequate processes in place to prevent a breach. We also note that the Procedures are not exhaustive in terms of the factors that may be considered by the Tribunal, which would currently allow the Tribunal to consider a Respondent's financial capacity should it be relevant to do so.

We have not proposed any amendments to the Procedures to specifically include a Respondent's financial capacity as an express matter that may be considered by the Tribunal in making a penalty determination. We are interested in views of submitters as to whether, and if so how, the financial capacity of a Respondent should be addressed within the penalty assessment process.