



NEW ZEALAND'S EXCHANGE  
TE PAEHOKO O AOTEAROA

# **NZX Participant Rules**

## **Booking Purposes Only Transactions**

Consultation Paper

July 2023

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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 NZX Participant Rules.

## Background

NZX Participant Rule (**Rule**) 10.13.9 requires NZX Participants to have appropriate systems and controls in place to prevent Orders being placed into the Trading System that result in Trades where there is no resulting change in beneficial ownership. This requirement supports NZX Participants in complying with the prohibitions contained in the Financial Markets Conduct Act 2013 (**FMC Act**) relating to market manipulation.

In 2021, NZX released a self-match prevention tool (**SMP**) which is a voluntary tool that NZX Participants may elect to use to assist them in managing their obligations under Rule 10.13.9. SMP automatically prevents two Orders for the same entity matching with each other in the Trading System to effect a Trade. Importantly SMP currently operates so that if entities for whom SMP is enabled are the same on the opposing side of the Order, the Orders will not match in the Trading System, and the passive (resting) Order will be withdrawn (**Cancel-Passive**). More information about SMP is contained in the [SMP Practice Note](#).

NZX wishes to enhance the operation of the SMP tool, to enable functionality that will allow a booking transaction to occur in relation to matching Orders who have the same beneficial owner on the opposing sides of the Order. This booking purposes only transaction (**BPOT**) will not result in a Trade occurring, will be visible only to NZ RegCo Surveillance and the NZX Participants who are party to the BPOT, will not be cleared through the Clearing House operated by NZX Clearing, and will otherwise operate in a similar manner to the ASX Unintentional Crossing Prevention tool (**ASX UCP**). BPOT will be an added SMP functionality that is available for NZX's securities markets (but not the NZX Derivatives Market<sup>1</sup>). NZX Participants may continue to elect to use SMP as they do now by selecting Cancel-Passive, or elect to use BPOT.

At the time SMP was introduced NZX Participants supported the introduction of BPOT functionality, noting that it would preserve Order integrity, be easier for Dealers to manage, and ensure consistency with the functionality offered by the ASX UCP. At that time NZX acknowledged this feedback, and noted that NZX would consider further developing the SMP functionality in future. As we have now had the opportunity to observe the effectiveness of the implementation of SMP, NZX considers it appropriate to introduce BPOT functionality, which will improve the sophistication of NZX's markets by enabling NZX Participants to undertake legitimate arbitrage trading strategies for their clients (supporting the relaunch of the S&P/NZX 20 Index Futures contract), and deliver the benefits identified in the 2021 consultation feedback. We have undertaken bilateral consultation with NZX Participants to ensure that the proposed design of BPOT will meet their needs, and enhance the operation of NZX's markets.

NZX is comfortable that the surveillance arrangements for NZX's markets, in particular for surveillance of potential market manipulation in relation to Order entry, remain appropriate. NZX also considers that the introduction of BPOT functionality will enhance the operation of NZX's markets on a fair, orderly and transparent basis consistent with NZX's obligations under the

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<sup>1</sup> Participants in NZX Derivatives Market will continue to be able to use the Cancel-Passive feature of SMP to assist them in complying with the obligations of NZX Derivatives Market Rule (**Derivatives Rule**) 8.7.10.

FMC Act, including because BPOT will deliver innovation to NZX's markets and promote confident and informed participation in those markets.

## Introduction

In order to enable the introduction of BPOT there are changes that need to be made to the NZX Participant Rules, which are set out in the Exposure Draft of the Rules and NZX Participant Procedures (**Procedures**) that accompany this Consultation Paper, these include:

- amendments to the Rules to establish eligibility and accreditation requirements in relation to BPOT (**Eligibility Proposal**),
- amendments to the Rules to ensure that there is appropriate disclosure to clients that BPOT are not cleared and settled through the Clearing House operated by NZX Clearing (**Disclosure Proposal**), and
- consequential amendments to ensure that the existing Rules that apply to transactions apply appropriately to BPOT (**Consequential Amendments Proposal**).

The above proposals are described in more detail in this Consultation Paper.

We are also proposing consequential changes to the Derivatives Rules and Procedures to reflect the operation of Cancel-Passive, as BPOT will not be available for the NZX Derivatives Market.

In addition, we are proposing to update the Self Match Prevention Practice Note (**Practice Note**) to reflect the introduction of BPOT within the SMP tool. An Exposure Draft of the Practice Note also accompanies this Consultation Paper.

NZX wishes to consult on the amendments to the Rules and Procedures, Derivatives Rules and Procedures, and Practice Note to ensure that:

- NZX's regulatory policy accurately reflects the manner in which BPOT is intended to operate,
- the proposed regulatory obligations that will apply to NZX Participants who elect to use BPOT (including in relation to accreditation and disclosure) are appropriate, and
- there are no unintended consequences for NZX Participants in relation to the design of the proposed regulatory settings that apply to BPOT.

## Consultation Process

We invite interested parties to provide their views on the proposed amendments by emailing a written submission to [policy@nzx.com](mailto:policy@nzx.com), or contacting us in order to make a verbal submission.

The closing date for submissions is **Friday 25 August, 2023**.

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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## Key features of BPOT

As noted above, one of the objectives of this consultation is to ensure that NZX's regulatory policy accurately reflects the manner in which BPOT is intended to operate. The Exposure Draft of the Practice Note provides detail of the operational requirements for utilising BPOT.

The key features of BPOT are described in further detail below.

### **NZX Main Board and NZX Debt Market only**

BPOT will only be available for the NZX Main Board and NZX Debt Market, it will not be available for the NZX Derivatives Market or the Fonterra Shareholders' Market.

### **Optional**

It is entirely optional for NZX Participants to use SMP to manage their obligations under Rule 10.13.9 and Derivatives Rule 8.7.10. The use of BPOT is also entirely optional.

### **SMP enables BPOT**

NZX Participants who wish to use BPOT must do so by having SMP enabled and, by specifying that the SMP action on an Order is booking purposes only (**BPO**).

NZX Participants who wish SMP to operate as it does now will need to specify 'Cancel-Passive' as the SMP action on an Order.

Where SMP is enabled for an NZX Participant, but no SMP action is specified, a Trade will occur as normal.

### **Orders must belong to the same NZX Participant and be for the same entity (SMP Key)**

In order for SMP to operate to either cancel the passive Order, or to enable a BPOT to occur, the Orders must belong to the same NZX Participant, be for the same entity (i.e. have the same SMP Key) otherwise a Trade will occur as normal. In relation to BPOT, NZX will allocate an SMP Key to a Participant, and the Participant will need to report the SMP Key it has used for an Approved BPOT Client on a quarterly basis.

### **SMP Action must be BPO for both Orders**

An NZX Participant must specify that the SMP action is BPO for each of the opposing Orders, to enable BPOT to occur. If a NZX Participant has enabled SMP, but has specified different SMP actions (BPO and Cancel-Passive) then a Trade will occur as normal.

## **No Trade occurs**

While BPOT results in a booking transaction for NZX Participants, no Trade occurs for the purposes of the Rules. A BPOT is only visible to the NZX Participant for whom the BPOT was effected (who will receive a FIX message from the Trading System), and to NZX Surveillance. A BPOT is not visible to the rest of the market and will not result in a price setting Trade.

## **Session States for BPOT**

BPOT is available during all Session States for the NZX Debt Market and NZX Main Board, but will only be effective during the Opening Order Match, the Normal Trading Session and the Close.

## **BPOT clearing arrangements**

BPOT will not be cleared or settled through the Clearing House operated by NZX Clearing. NZX Participants will be able to implement their own arrangements in relation to the settlement of a BPOT.

The BaNCS clearing system will send a BPOT 'non-settled' trade message during the day that the BPOT occurs.

A Participant will have the discretion to elect whether to complete settlement for the BPOT. If the Participant elects to settle the transaction the Participant may determine the settlement period that is to apply to the BPOT.

A Participant will have complete discretion in relation to the post transaction arrangements that apply to a BPOT.

# **Eligibility Proposal**

NZX initially intends to restrict the availability of BPOT to certain clients of NZX Participants, based on our understanding of the types of clients who will wish to undertake sophisticated trading strategies that BPOT is designed to enable.

We intend to reconsider the need for the proposed eligibility requirements (and consequential accreditation requirements) once we have had the opportunity to review the effects of BPOT on NZX's markets.

## **Eligibility requirements**

### **Trading Participants Acting as Principal**

BPOT will be available for Trading Participants who are Acting as Principal (including when the Trading Participant is acting as a Market Maker).

### **Institutional Clients**

It is initially proposed that BPOT is made available solely for clients who are Institutional Clients as that term is defined in the Rules, which includes a person whose principal business is the investment of money or who, in the course of and for the purpose of their business, habitually invests money.

We understand from our initial engagement with NZX Participants that the BPOT tool will be most useful for these types of clients who wish to undertake complex arbitrage trading activities, particularly in light of the proposed refresh of the S&P/NZX 20 Index Futures contract.

### Recognised BPOT Jurisdiction

We also propose that as part of the initial implementation, that BPOT is only made available for Institutional Clients from Recognised BPOT Jurisdictions. NZX will determine whether a jurisdiction should be designated as a Recognised BPOT Jurisdiction, based on analysis as to whether a jurisdiction's securities exchange regulator is a member of IOSCO, and whether the jurisdiction has market manipulation requirements which are substantively similar to those contained in section 265 of the FMC Act. A list of Recognised BPOT Jurisdictions will be included in the Procedures, based on NZX's initial benchmarking research, which will be Australia, Singapore, Hong Kong, the United Kingdom, the United States, Canada and New Zealand. NZX will additionally have the power to determine a jurisdiction to be a Recognised BPOT Jurisdiction and will publish a list of all Recognised BPOT Jurisdictions on its website.

NZX does not consider that BPOT inherently increases the risk of market manipulation, given that the BPOT will only be visible to the NZX Participant for whom the BPOT is effected, and Orders giving rise to the BPOT will be surveilled in the same manner as other Orders to ensure the detection of potential market manipulation. However, we consider that the imposition of a requirement that an Institutional Client is domiciled in a Recognised BPOT Jurisdiction to be an appropriate additional protection for the initial establishment phase of enabling BPOT, to provide additional comfort that BPOT will not increase the risk of manipulation in NZX's markets.

### Client confirmation

NZX is also proposing that NZX Participants obtain a description from an Institutional Client for whom it wishes to undertake BPOT that describes the client's arrangements for ensuring that the client's employees who are instructing the trade have no prior knowledge that the transaction will not result in a change in beneficial ownership, and a confirmation that the client considers those arrangements to be adequate.

NZX considers that this will operate as an additional protection to further decrease the likelihood that Orders relating to a BPOT are entered for market manipulative purposes. NZX intends to revisit whether this confirmation remains necessary after the initial establishment phase of BPOT.

## Accreditation process

### Application

We intend to include a requirement in the Rules that a NZX Participant who wishes to undertake BPOT for an Institutional Client provides an application to NZX that includes a confirmation that it has obtained the required confirmations from its client.

The NZX Participant can then only provide BPOT for a client once NZX has permitted it to do so, with that permission being provided on a per client basis.

## Disclosure Proposal

One of the key features of BPOT is that the resulting transaction will not be cleared or settled through the Clearing House operated by NZX Clearing.

NZX does not consider it appropriate to require, or enable, central counterparty clearing for these transactions given that BPOT in essence gives rise to a booking entry for the same NZX Participant. NZX Participants will continue to be able to obtain confirmation messages from BaNCS to confirm that a BPOT has occurred.

Rule 15.8.1(b) requires that a Client Advising Participant must ensure that details of the manner in which Trades are cleared and settled are provided to clients, including Institutional Clients, before accepting an Order. NZX considers that it is an important that Institutional Clients understand that BPOT will not be cleared and settled through the Clearing House in the same manner as a Trade, and intends to amend Rule 15.8 to require this disclosure to be made before BPOT can be enabled for a client.

NZX Participants will have the complete discretion to negotiate the settlement period for the BPOT, or to elect not to undertake settlement of the BPOT and to determine the other post-transaction arrangements that apply to BPOT. NZX is proposing to include a new Rule 10.13.14 that will support the requirements of Rule 15.8 and will require that Participant discloses the following information to a client for whom BPOT is to be enabled:

- that BPOT are not cleared and settled through the Clearing House,
- that the Trading Participant has discretion as to whether the BPOT is settled, and
- any post transaction arrangements that apply to BPOT.

Participants must also keep a record of the disclosure being made to the client.

## Consequential Amendments

In addition to the changes outlined above there are a number of consequential and conformance style changes that NZX proposes to make to the Rules. These include changes relating to:

- the definition of Off-Market Trade and Crossing (which currently refers to transactions rather than Trades), to ensure that BPOT are not captured within these definitions,
- conformance changes to the manner in which Trades and transactions are treated within the Rules, and
- the NZX Derivatives Market Rules and NZX Derivatives Market Procedures to clarify the manner in which the Cancel-Passive SMP feature operates.



## Consultation Questions

We invite general feedback in relation to the proposed amendments to the Rules, Procedures, NZX Derivatives Market Rules and Procedures and Practice Note that are set out in the Exposure Drafts that accompany this Consultation Paper. In addition, we invite specific comment in relation to the following questions:

1. Are there any changes that you consider need to be made to the Exposure Drafts to reflect the manner in which BPOT is intended to operate?
2. Do you consider that the proposed eligibility criteria for using BPOT are appropriate?
3. Are there any other matters that you consider NZX Participants should be required to disclose to Institutional Clients in relation to BPOT?
4. Do you have any comments on the proposed consequential amendments to the Exposure Drafts?
5. Are there any additional consequential amendments that you consider NZX needs to make to the Exposure Drafts?