



JUNE 2022

# Market operator obligations review

## NZX

Findings from the FMA's review of how well NZX is meeting its licensed market operator obligations, for the period 1 January to 31 December 2021

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# Contents

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<b>Executive summary</b>	<b>3</b>
About this report	3
How we approached this review	3
Overall assessment	4
Recommendations	4
<b>NZX</b>	<b>6</b>
Obligations	6
Governance arrangements and oversight	6
Technology capability	7
Targeted technology review and action plan	7
5 August incident	9
Overall observations	9
Crisis management framework and planning for significant market events	10
Conflicts management	10
Risk management	11
<b>NZX Regulation Limited (NZ RegCo)</b>	<b>13</b>
Obligations	13
Governance arrangements and oversight	13
Effectiveness of arrangements	14
Operations of NZ RegCo	15
Monitoring of conduct	15
Arrangements for enforcement of compliance with market rules	18
Overall assessment	18
<b>Appendix 1: Our role in reviewing NZX</b>	<b>19</b>
Our role	19
Market operator obligations	19
NZX licensed markets	20
Our oversight of NZX	20
<b>Appendix 2: Ratings explained</b>	<b>21</b>

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# Executive summary

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## About this report

The Financial Markets Conduct Act 2013 (FMC Act) requires the FMA to carry out a review and report on how well NZX is meeting its licensed market operator obligations. One of the key objectives of these reviews is to act as a mechanism to ensure that potential conflicts between regulatory and commercial functions of NZX, as a self-regulating organisation, are appropriately managed. The FMA may carry out this review at any time but must do so at least once a year.

This report is on the review of NZX for the period from 1 January to 31 December 2021 (“the review period”).

## How we approached this review

Each year, we select the areas of focus for our review and determine what monitoring we will undertake throughout the review period. This year the scope and frequency of our monitoring were also influenced by the NZX’s action plan to address the FMA’s targeted technology review<sup>1</sup> findings, which was due to be completed by 31 December 2021. The action plan scope went beyond technology aspects to include governance arrangements, risk management and industry engagements.

Consequently, throughout the year we employed several mechanisms to assess NZX’s compliance with its market operator obligations. This included reviews of regulatory reports provided to us, engagements with NZX and NZX Regulation Limited (NZ RegCo), sample testing of regulatory decisions and processes, monthly updates, discussions and reviews of NZX’s progress with its action plan, market participant surveys, desk-based inspection of a significant number of documents, and on-site discussions with representatives of the NZX and NZ RegCo Boards, NZX Board Committees, and key staff.

The scope of this year’s review was also influenced by:

- the review period covering the first full year of operation under a new regulatory model
- incidents occurring during the review period
- other areas noted in our previous review, for the year ended 31 December 2020 (“[June 2021 report](#)”)
- ongoing monitoring, and feedback we have provided to NZX or NZ RegCo.

We employ a risk-based approach to monitoring, and while this review is of NZX’s overall compliance with its licensed market operator obligations, we have exercised judgement in selecting the areas of focus, and the level and detail of work performed in each. This report highlights our main findings and observations from the review and, as with any risk-based approach, has inherent limitations.

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<sup>1</sup> The outcome of the targeted review was published in January 2021 and is available on the [FMA website](#).

## Overall assessment

The FMA's overall conclusion is that NZX complied with its licensed market operator obligations during the review period, other than in respect to the matters covered by the action plan where compliance was not achieved until the end of the review period. This was due to the time needed to design and implement an action plan, and the need for NZX to achieve sufficient uplift through successful delivery of a critical mass of actions from the action plan.

In a challenging pandemic-dominated environment, NZX has done well to implement significant improvements and achieve compliance with its licensed market operator obligations. Some of the key highlights for the review period include:

- successful implementation and execution of action plan
- a notable investment in people, processes and systems
- significant uplift in its technological maturity, system sustainability, resiliency and risk capability, with continued enhancement and maintenance focus
- an uplift in capability with recruitment of experienced personnel and design of new key roles
- market participant feedback reflecting improved engagement with the industry through dedicated relationship management arrangements, introduction of the Technology Working Group, and more open dialogue
- downward trend in market-impacting incidents
- NZ RegCo operated effectively during its first full year, continuously enhancing its frameworks and arrangements to support its work, and demonstrating an appropriate level of independence from NZX.

We thank NZX and NZ RegCo staff for their constructive engagements during 2021 and our on-site review in 2022. We recognise the significant effort that has gone into implementing and executing the action plan, and maturing the exchange's operations alongside its normal business activities.

While significant improvements have been achieved, it will be important for NZX to continue its trajectory of continuous improvement and build on the progress made in 2021.

## Recommendations

We recommend the following further enhancements:

Who	Area	Recommendation	Rating
NZX	Risk management	The current risk management arrangements demonstrate a significant step forward, however NZX should continue to work on building and embedding its second line of defence to ensure it is robust and operates with appropriate levels of independence.	Medium

NZX	Technology	<p>Acknowledging the improvements to date, we recommend NZX maintain its focus on:</p> <ul style="list-style-type: none"> <li>• Further development of the NZX IT strategy and architecture roadmaps</li> <li>• Regular assessment of IT resilience, risk posture and mitigation plans</li> <li>• Implementation of conformance (integration) standards with market participants</li> <li>• Delivering on continuous improvement plan</li> </ul>	Medium
NZX and NZ RegCo	Significant market events	NZX and NZ RegCo should continue to mature and refine the Crisis Management Framework and arrangements for managing significant market events. This includes having a broader set of well-developed and documented scenarios of potential significant market events, including triggers and event management plans.	Medium
NZ RegCo	Referrals to Tribunal	NZ RegCo should maintain focus on the timeliness of its referrals to the Tribunal and, where they fall outside of the target service levels, consider where efficiencies may be achieved.	Medium

## Obligations

While NZX is responsible for ensuring it meets all of its obligations set out in the FMC Act, its regulatory functions (such as monitoring of the markets) are carried out by NZX Regulation Limited (NZ RegCo), a subsidiary of NZX which has a separate Board, management and staff.

Accordingly, we have segmented our review, with different areas of focus for NZX and NZ RegCo. In this part of the report, we focus on the commercial aspects of NZX, including its strategy, infrastructure, and overall performance in the context of the following market operator obligations:

- *to the extent that is reasonably practical, doing all things necessary to ensure that its licensed markets were fair, orderly and transparent (FOT obligation)*
- *to have adequate arrangements to notify disclosures made to it under a disclosure obligation, and continuing to make those disclosures available*
- *to have adequate arrangements for handling conflicts between its commercial interests and the need to ensure its markets operate in a fair, orderly and transparent way*
- *to have sufficient resources (including financial, technological and human resources) to properly operate its licensed markets.*

Within the above, we had the following key areas of focus:

- Governance arrangements and oversight
- Technology capability
- Crisis management framework
- Conflicts management
- Risk management

## Governance arrangements and oversight

### **Background and review**

The NZX Board plays a critical role in developing and embedding organisational culture, and has the ultimate accountability for ensuring that the markets are operated and regulated in a compliant and effective manner. It does so through setting strategic direction, good risk management practices, and ensuring

appropriate levels of oversight (including oversight of resource allocations) and investment into its market operator operations.

During the year, our monitoring of NZX has required significant, often granular, focus in technical areas including the technology capability uplift. Given the importance of appropriate governance arrangements and oversight, we then focused our on-site monitoring more heavily on governance arrangements.

We noted that NZX made a number of changes and undertook initiatives with respect to its governance arrangements during the review period, including:

- undertaking a review, with independent advice, of NZX Group's corporate governance arrangements
- updating its corporate policies and introducing several new policies, including the NZX Complaints Policy and NZX Complaints Procedure
- changes to Board and Committee compositions, and introducing several new roles targeted at risk and technology capability
- enhancing its trend monitoring arrangements.

As part of our review, we also considered the content of the Board reporting and the discussions that take place at the Board and Board Committee levels, escalation of issues to the Board, and the level of oversight in relation to risk management and market operator obligations, including the resourcing aspects. We met with the Chairs of the Audit and Risk Committee, Human Resourcing Committee and Technology Committee, as well as the CE and Head of Policy and Regulatory Affairs. We also met the Chair and CE of NZ RegCo as a significant function and subsidiary.

### ***FMA observations***

From the discussions and information, we observed that:

- there is a good level of oversight and engagement by the Board
- the reporting provided to the Board and committees is detailed
- there has been an increased focus on sufficiency of resourcing, with detailed assessments carried out in a number of areas following the FMA targeted review and action plan
- NZX made additional investment in resourcing and retention, including within NZ RegCo.

## **Technology capability**

### **Targeted technology review and action plan**

#### ***Background and review***

During 2020, the FMA completed a targeted review, which concluded that NZX failed to meet its market operator obligations due to not having sufficient technology capability across people, processes and platforms. These deficiencies contributed to the following significant operational failures:

- April 2020: Inadequate capacity to support trading at heightened volumes



- August 2020: Market halt due to a targeted Distributed Denial of Service (DDoS) cyberattack

On 5 May 2021, FMA approved the NZX action plan to address the targeted review findings. The plan contained the following five workstreams:

- Enhancing organisational structures and specialist talent acquisition
- Lifting IT maturity practices and system sustainability
- Strengthening security and operational resilience of its networks and infrastructure
- Improving industry engagement and collaboration
- Expanding and enhancing risk and crisis management protocols

Each workstream detailed a comprehensive list of actions to address the FMA's findings, with a targeted completion date of 31 December 2021.

We have closely monitored NZX's progress, with regular project updates and evidence-based reviews. An interim review was completed in October 2021, with a final review in February and March 2022.

### ***FMA observations***

NZX made a notable investment during the year into people, processes and systems. Our final review verified that NZX had successfully implemented the agreed actions and developed an ongoing enhancement and maintenance plan to address our previous concerns.

Overall, NZX achieved a significant uplift in its technical maturity, system sustainability, resiliency, risk capability and industry relationships. This uplift was achieved in a challenging pandemic-dominated environment, with 106 improvements delivered at a steady pace by internal and external resources.

Key outcomes across the five workstreams were:

- recruitment of experienced IT leadership and knowledgeable technical specialists into key roles and the expansion of technology competencies
- enhancements across IT strategic roadmaps, risk management oversight and governance reporting
- improvement of project delivery disciplines, operational practices, quality controls and management reporting tools
- implementation of the Nasdaq Trading System Upgrade
- improvement of IT incident protocols, with a greater focus on reliability, availability and serviceability
- completion of a multi-staged Network Transformation programme and expansion of the IT security framework
- introduction of a structured industry engagement framework, with a focus on two-way communication and collaboration
- establishment of a risk-based prioritisation approach to continually refresh and modernise applications and platforms
- implementation of alternative arrangements for notification of market announcements
- successful completion of the NZX Disaster Recovery Plan in October 2021, with an emphasis on a structure crisis simulation event and independent assessment.

## 5 August incident

### **Background and review**

While the overall performance and reliability of the systems improved in 2021, there was one major incident during the year that led to a market halt.

On 5 August 2021, an NZX operator logged into an incorrect environment to test a solution for an issue raised by a market participant. This ultimately resulted in multiple participants being disconnected from the trading system and the market being placed into a halt status, within which the connected participants could place, amend or cancel orders, but no trading could occur. The incident resulted in the markets being down for a 2-hour period and no closing match being held in relation to the NZX Securities Markets.

We engaged with NZX following the incident to understand the root cause (including any parallels with the 28 August 2018 market outage caused by a user erroneously logging into an incorrect system environment<sup>2</sup>). NZX promptly provided information and engaged in discussions with the FMA, acknowledging early that further enhancements were needed to its controls. We welcomed NZX proactively providing us with a plan containing 13 actions to address control and environment weaknesses and further mature IT capability, with progress on implementation of these actions being added to the monthly action plan reporting to the FMA.

### **FMA observations**

Following the 28 August 2018 incident, NZX implemented additional controls and made process changes to prevent users accessing incorrect environments (including production and DR environments requiring jump host (i.e separated) access, and different usernames being used for the conformance testing environment). We assessed that NZX had controls in place that, had they been fully followed by staff, would have prevented the 2021 issue. However, we also considered that while the immediate root cause was a staff member not following process, there were additional controls that were available to NZX that, had they been implemented, would have prevented the market halt. We also flagged that the production recovery processes were not straightforward and noted this as an area for improvement.

Given the broader work on technology uplift at the time, we considered that the deliverables on the action plan and the additional actions submitted by NZX to improve the control environment would sufficiently address the issues that led to 5 August incident. We subsequently confirmed that NZX delivered on its 13-point action plan.

## Overall observations

FMA has concluded that all agreed actions have been implemented by NZX, with future enhancement and maintenance plans in place to address previous review deficiencies. It is important for NZX to build on the improvements achieved in 2021, and its plan demonstrates an investment in continuous improvements in 2022 and beyond. We expect to continue to engage with NZX in the current review period on:

- further development of the NZX IT strategy and architecture roadmaps

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<sup>2</sup> This incident and FMA assessment at the time are described in the NZX Annual Obligations Review for YE12/2018, published in 2019.

- ongoing uplift of project delivery and IT operations best-practice disciplines
- regular assessment of IT resilience, risk posture and mitigation plans
- implementation of conformance (integration) standards with market participants

## Crisis management framework and planning for significant market events

### **Background and review**

We considered the NZX's crisis management framework and NZX's overall preparedness to respond to significant market events. Significant market events are those that materially disrupt the fair, orderly and transparent functioning of the market. They may be triggered by market participants' inability to connect to the systems, but can also relate to certain significant market movements, failures of other critical market services, or failures of entities.

We engaged separately with NZ RegCo, given that the significant market events may have regulatory implications. We reviewed NZ RegCo's arrangements to deal with significant market events and any initiatives it currently has in progress to enhance such arrangements.

During the year, NZX reviewed its crisis management arrangements, developed a compendium of scenarios across its functions, carried out a crisis simulation event, and improved its resiliency. NZ RegCo was involved in the consideration of the regulatory implications, potential responses and mitigation strategies in relation to the scenarios. NZ RegCo concurrently worked on further enhancing its regulatory arrangements, including considering additional "circuit breaker" controls and "trade with caution" flags to deal with unexplained market volatility.

### **FMA observations**

Overall, there has been an uplift in the maturity of NZX's crisis management framework, and there are currently several initiatives in progress to further mature the framework, processes and scenario planning. NZX and NZ RegCo should ensure that their approach includes a broader set of well-developed and documented scenarios of potential significant market events, including triggers and event management plans. We expect to continue to engage with NZX and NZ RegCo with respect to refinements to the crisis management framework and scenario testing.

## Conflicts management

### **Background and review**

NZX is required to have adequate arrangements in place to manage any actual or perceived conflicts of interest between its regulatory responsibilities and its commercial interests. Appropriate conflict management arrangements are especially important for maintaining market confidence in NZX as a self-regulating organisation, which is why each year we include these arrangements in our planned review scope.

This year, we considered:

- outcomes of an external review of its arrangements

- potential impact of the strategic direction of NZX on its obligations as a market operator of licensed markets
- how NZX considers potential implications of new business initiatives on its obligations as a market operator of licensed markets
- how NZX ensures it makes adequate investment into its operations to deliver on its market operator obligations
- level of challenge and independence exercised by NZX's regulatory function
- areas noted in our previous review, namely protocols in relation to policy setting.

### ***FMA observations***

Our observations are:

- conflict management arrangements at NZX are mature, with different functions having good awareness of segregation between regulatory and commercial functions
- there is no evidence to suggest that NZX is growing other aspects of its business at the expense of meeting its market operator obligations and running of the exchange
- NZX's strategy for growth includes specific consideration of market growth and improving market liquidity
- NZX has made a significant investment in the uplift of its people, processes and platform capabilities
- NZX and NZ RegCo operate with an appropriate level of separation, and NZ RegCo continues to operate with a high degree of independence
- The relationship between NZX Policy and NZ RegCo is mature, with a high level of respect. No major conflicts have emerged throughout the review period and NZ RegCo and NZX Policy worked well to agree prioritisation of regulatory workstreams.

## **Risk management**

### ***Background and review***

Good risk management practices form an important part of a market operator's ability to demonstrate it has, to the extent that is reasonably practicable, done all things necessary to ensure that each of its licensed markets is a fair, orderly and transparent market, and to demonstrate adequacy of its arrangements and sufficiency of resources.

NZX has adopted a "3 lines of defence" approach to risk management, whereby the business risks are owned by business units and challenged and overseen by a risk management function, and external assurance is undertaken to further assess and evaluate controls and functions in a structured way.

During the review period, we engaged with NZX in relation to enhancements to its risk management framework and practices, and additional risk-dedicated resources and roles. During the review period, NZX:

- undertook a review of its risk management framework and risk appetite statement
- refreshed its risk registers

- reviewed resourcing needs for its risk management function, with assistance from an external provider
- clarified roles and accountabilities with respect to risk ownership and oversight, including the creation of Chief Risk Officer role with overall responsibility for risk management
- added a Risk and Compliance Manager role in Core Markets and IT, and designed a General Manager of Risk role to further strengthen its second line of defence
- enhanced awareness of risks across the organisation and embedded more active consideration of risks in its operations
- enhanced risk reporting to the Audit and Risk Committee
- enhanced trend monitoring arrangements.

### ***FMA observations***

Structurally, risk management is now an established function of NZX, with dedicated resource. While this is still a journey, with the function needing to be fully embedded within the business, there is a good level of support, respect, and engagement to date. Overall, across the organisation there is a much greater focus and active consideration of risks, risk management and mitigation.

The current risk management arrangements demonstrate a significant step forward, however NZX should continue to work on building and embedding its second line of defence to ensure it is robust and operates with appropriate levels of independence.

# NZX Regulation Limited (NZ RegCo)

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## Obligations

While NZX is responsible for ensuring it meets all its obligations set out in the FMC Act, the regulatory functions (such as monitoring of the markets) are carried out by NZX Regulation Limited (NZ RegCo), a subsidiary of NZX which has a separate Board, management and staff.

NZ RegCo is subject to a charter, which sets out its objectives, responsibilities, and overall operational framework.

In this part of the report, we focus on the following obligations of NZX as relevant to the NZ RegCo function:

- *to the extent that is reasonably practical, do all things necessary to ensure that its licensed markets were fair, orderly and transparent (FOT obligation)*
- *have adequate arrangements for monitoring the conduct of participants on or in relation to the markets (Monitoring Obligation)*
- *have sufficient resources (including financial, technological and human resources) to properly operate its licensed markets.*

Within the above, we had the following areas of focus:

- Governance arrangements and oversight
- Effectiveness of arrangements following its first full year of operation
- Operations of NZ RegCo:
  - Market integrity and orderliness
  - Arrangements for monitoring conduct on NZX licensed markets

We additionally considered arrangements for enforcing compliance with the market rules.

## Governance arrangements and oversight

### **Background and review**

The NZ RegCo Board comprises 5 directors, 4 of whom are independent, and 1 director who is a director of both NZX and NZ RegCo. During the year, the Board transitioned from an establishment board, with permanent directors being appointed for a three-year term. A rotation policy ensures approximately one-third of directors rotate each year.

As part of our review, we considered:

- the level of reporting and oversight
- escalations to the Board
- how regulatory decisions are being made
- how adequacy of resourcing is monitored
- engagements with NZX during the year.

We also took into account the content of the Board reporting, the discussions that take place at Board level, and the level of oversight by the Board, including over resourcing aspects. We also met with the Chair of NZ RegCo, the cross-over director and the CE.

### ***FMA observations***

From the discussions and information, we observed the following:

- in-depth level of reporting and oversight, with an appropriate level of support and challenge
- reserved matters are appropriately escalated to the Board. There also appears to be good proactive engagement with the Board for matters not formally requiring a Board decision
- appropriate level of attention to resourcing levels and maintaining adequacy of the same. During the year NZ RegCo carried out a benchmarking exercise that aimed to obtain independent assessment and ensure appropriate pay for its staff, supporting retention.

## Effectiveness of arrangements

### ***Background and review***

In the prior review, we looked at establishment documents, including charters, protocols and policies, to assess the design of NZ RegCo. We found the overall design well planned and initial implementation well executed, and noted a focus for the next review would be on operating effectiveness.

As part of this review, we considered enhancements undertaken to respond to FMA observations, and other improvements and initiatives driven by NZ RegCo. We engaged with NZ RegCo personnel on a number of occasions during the review period, including (as noted elsewhere in this report) in relation to reviews of NZ RegCo files and at on-site discussions with both NZ RegCo and NZX personnel.

In considering operating effectiveness we also considered:

- NZ RegCo policies, frameworks and protocols
- NZX Policy work undertaken, and prioritisation considerations
- NZX and NZ RegCo interactions and engagements during the review period, including at the operational and Board level
- NZ RegCo challenges of NZX and escalations to its Board, if any.

## **FMA observations**

We have the following observations:

- The relationship between NZX Policy and NZ RegCo is mature with a high level of respect. Enhancements to protocols were made during the review period and no major conflicts or prioritisation issues arose.
- NZX and NZ RegCo operate with an appropriate level of separation, and NZ RegCo continues to operate with a high degree of independence.
- There is a good flow of information between NZX and NZ RegCo, primarily through the cross-over director and NZ RegCo CE reporting.

## **Operations of NZ RegCo**

### **Background and review**

The NZ RegCo Board, in conjunction with NZ RegCo management, sets the strategy for NZ RegCo. This year NZ RegCo implemented additional operating performance benchmarking to complement its internal and external service levels for assessment of operational delivery, with focus on four strategic objectives: compliant markets, market development and infrastructure, regulatory empowerment, and staffing and capabilities.

During the year, we reviewed regulatory reporting from NZ RegCo, undertook sample reviews of regulatory decisions, and met with the representatives of NZ RegCo. We also engaged as required during the year on areas of mutual interest.

Below we document our observations and recommendations within each NZ RegCo function.

### **Monitoring of conduct**

NZ RegCo must have adequate arrangements for monitoring the conduct of participants in NZX's market. Multiple NZ RegCo teams contribute to those arrangements and NZ RegCo's ability to deliver on its mandate, including Surveillance, Participant Compliance, Market Conduct, and Issuer Regulation.

#### **Surveillance**

Surveillance performs the frontline oversight of trading on NZX's markets, via real-time and post-trade monitoring. The proper functioning of this team is essential to maintaining market integrity.

With continued focus on its effectiveness in detection of market abuse, we reviewed documents and held discussions regarding the performance and effectiveness of the upgraded SMARTS<sup>3</sup> Alerts suite, operation of and enhancements to the misconduct investigation processes, case management procedures and internal reporting obligations, and how market developments influence the team's approach to surveillance, including social media monitoring.

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<sup>3</sup> The market surveillance system used by NZX



We also considered the team's experience and capacity for handling monitoring activities, and working relationships with other NZ RegCo teams as well as the wider NZX.

Overall, we were satisfied that surveillance arrangements are adequate and appropriately resourced (including skill level) to ensure that market surveillance is operating effectively. We observed:

- recruitment of further senior resource, which enhances overall experience of the team and business continuity planning arrangements
- high-quality referrals being made to the FMA with detailed appendices
- focus on ensuring that its monitoring tools are fit for purpose – examples include a validation exercise for the SMARTS Alerts upgrade, and consideration of the gaps in NASDAQ's SMARTS product offerings and possible misconduct scenarios, which are then supplemented with additional tools
- refining the approach to social media monitoring and undertaking monitoring of major social media sites/chat rooms to support investigations of anomalous trading
- continued engagement with NZX Participants and their offshore clients to ensure optimum operation of algorithms in NZ markets.

### ***Participant Compliance***

The Participant Compliance team administers the NZX Participant Rules, NZX Derivatives Market Rules, Clearing & Settlement Rules and Depository Operating Rules, and supervises compliance with those rules by market participants. The proper functioning of this team is essential to monitoring and enforcing compliance with the market rules, market integrity and fair application of NZX's rules.

With focus on Participant Compliance's effectiveness in monitoring market participants, for this review period we looked at documents and interviewed staff about the team's activities and performance, enhancements made to the participant portal and the participant monitoring plan, the team's experience and capacity for handling monitoring activities, and broader working relationships with other NZ RegCo teams and the wider NZX teams, such as Policy.

During our file reviews, FMA considered the application of rules, level of inquiry undertaken and the regulatory decision-making process. We found NZ RegCo decision making to be well supported by process and documents.

Overall, we are satisfied that the Participant Compliance function operates well and remains focused on improving the quality and robustness of its oversight and monitoring functions. The Participant Compliance team is sufficiently resourced to carry out its core functions, with the team's approach of functioning as generalists and having well documented processes to help reduce key person risk.

For the review period, we note that:

- The Participant Compliance inspection programme was delivered, with some adjustments in light of COVID-19 related restrictions to move to desk-based inspections.
- The team's inspection report feeds into a risk profile and rating for each participant to govern future targeted monitoring. These reports are also provided to the NZ RegCo Board, CE and Head of Clearing (without compromising any confidential information) as required, to allow for comparisons between Participants, and trend analysis.

- Enhancements were made to the Participant Portal including automating information requests to Participants to minimise the information risk associated with manual receipt and storage of information.
- The Participant Compliance team is headed up by a highly experienced staff member. Participant Compliance is managing key person risk and building a knowledge-sharing culture within the team by having all team members work as generalists able to work on any matter that comes across the desk.

### ***Market Conduct***

The Market Conduct team is responsible for investigating potential breaches of the Listing Rules by listed issuers. Where a breach is identified, it may issue an infringement notice or refer the matter to the NZ Markets Disciplinary Tribunal (Tribunal). It also supports Participant Compliance with the breaches of Participant Rules where a referral to the Tribunal is appropriate. The responsibilities of the Market Conduct team were previously carried out by the Issuer Compliance team, which was split into Market Conduct and Issuer Regulation to allow for greater focus and specialisation of the teams.

During the year, we undertook sample reviews of matters handled by Market Conduct, which included continuous disclosure matters. We considered the treatment of matters to be well documented and supported by analysis and supporting information. As part of our review, we also spoke to the Head of Market Conduct. We gained comfort that the process enhancements implemented last year helped to mature the NZ RegCo approach, and that the processes operated well during the year.

Last year, we also recommended NZ RegCo continue to focus on improving capability with regards to monitoring and assessing issuer compliance with financial reporting obligations, and utilise financial reporting experts when performing such surveillance to ensure reviews are as in-depth as necessary.

We noted that NZ RegCo expanded its utilisation of external providers in respect of financial reporting, assurance matters, and sector expertise. Our engagement with NZ RegCo during the review period, and the outcomes of enquiries, demonstrated that these arrangements have served to enhance the team's capability with regards to financial reporting matters.

### ***Issuer Regulation***

The Issuer Regulation team engages with the market on applications and transactional work. This includes reviews of offer documents, listings, de-listings, waivers, rulings and notices.

As noted above, Issuer Regulation (and Market Conduct) were formed from the previous Issuer Compliance team to allow for greater specialisation and focus on technical areas.

During the year, we reviewed sample files of select regulatory decisions, and also engaged with the head of the function in relation to the operation of the team during the review period.

Overall, we were satisfied with the quality of the files we reviewed. We noted no systemic issues, and the files were generally comprehensive. In one matter we had an observation that the file did not evidence a sufficiently robust review of an Issuer's reasons for not presenting prospective financial information (although the relevant issues were appropriately identified and escalated).

## Arrangements for enforcement of compliance with market rules

### Referrals to the NZ Markets Disciplinary Tribunal

NZ RegCo is responsible for monitoring and enforcing all NZX market rules. Where it identifies a potential breach of the NZX market rules, NZ RegCo may refer the matter to the NZ Markets Disciplinary Tribunal (Tribunal), an independent body established under the NZ Markets Disciplinary Tribunal Rules. The Tribunal's principal role is to determine whether there has been a breach of the Market Rules in matters referred to it by NZ RegCo and if so, what penalties, if any, may be imposed.

Overall, the arrangements between NZ RegCo and the Tribunal are working well. During the review period, there was an increase in matters referred to the Tribunal, and the quality of NZ RegCo's submissions increased. Since the introduction of the infringement regime, matters referred to the Tribunal are more complex. The length of time for NZ RegCo to refer matters to the Tribunal has also increased. NZ RegCo accepts the importance of timely referrals to the Tribunal and has processes in place to support and monitor the timeliness of its inquiries and referrals to the Tribunal.

### *FMA observation*

We acknowledge that there are a number of factors that contribute to the time needed for NZ RegCo to complete an investigation and determine whether to make a referral, some of which are outside of NZ RegCo's control. However, there is a risk that the extended timelines may undermine the value of the Tribunal's findings to the market. NZ RegCo should maintain focus on the timeliness of its referrals to the Tribunal, and if they consistently fall outside of target timeframes, consider where efficiencies can be achieved.

## Overall assessment

NZ RegCo operated effectively during its first full year, enhancing its frameworks and arrangements to support its work. Its vision and strategy are clearly articulated in the documents we reviewed. NZ RegCo has been mindful of resourcing and has implemented actions to retain staff, as well as considering risks around its senior resource. There has been some turnover and successful recruitment of experienced resource (eg surveillance, participant compliance) and overall, resourcing levels and capabilities appear adequate.

# Appendix 1: Our role in reviewing NZX

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## Our role

The FMA is an Independent Crown Entity and one of two main regulators of New Zealand's financial markets. Our purpose is to promote and facilitate the development of fair, efficient and transparent financial markets.

Under the FMC Act, we are required to review, at least annually, how well a licensed market operator is meeting its obligations. We are also required to publish a written report of the review.

If we consider, after carrying out a review, that a licensed market operator has failed or is failing to meet any one or more of its market operator obligations, it may, by written notice, require the licensed market operator to submit an action plan to the FMA.

## Market operator obligations

In the FMC Act, 'market operator obligations' means:

- the general obligations in respect of licensed markets (section 314):
  - to ensure, to the extent that is reasonably practicable, that each of its licensed markets is a fair, orderly and transparent market
  - to have adequate arrangements for notifying disclosures made to it from participants in its markets, and for continuing to make those disclosures available
  - to have adequate arrangements for handling conflicts between its commercial interests and the need to ensure its markets operate in a fair, orderly and transparent manner
  - to have adequate arrangements for monitoring the conduct of participants in its markets
  - to have adequate arrangements for enforcing compliance with market rules
  - to have sufficient resources (including financial, technological and human resources) to operate its licensed markets properly
- an obligation to respond to a request from the FMA to make changes to market rules (section 333)
- an obligation to give the FMA an annual self-assessment of compliance with its obligations (section 337)
- an obligation to act on the directions of the FMA or the Minister, if the operator is found to be failing to meet any of its obligations (sections 340 to 342)
- any obligation imposed as a condition of a market operator's licence.

## NZX licensed markets

NZX is licensed to operate the following markets in New Zealand:

- NZX Main Board
- NZX Debt Market
- Fonterra Shareholders' Market
- NZX Derivatives Market

Details of NZX's licences are on [our website](#).

## Our oversight of NZX

The Memorandum of Understanding between the FMA and NZX, signed in January 2015, sets out the principles for our engagement and co-operation, and provides for regular operational meetings. This allows NZX to continually update FMA about its key initiatives and developments throughout review periods. There is also an agreed set of protocols for communications regarding normal business activities concerning both parties.

Our ongoing oversight of NZX in this review period included:

- monthly monitoring of NZX's progress with its action plan
- workshops on specific topics, particularly in relation to NZX's action plan
- operational meeting with NZ RegCo representatives
- reviews of NZ RegCo regulatory reporting and select matters
- discussions about market matters arising, as required
- consulting on NZX policies and proposed rule changes where appropriate
- providing feedback on NZ RegCo referrals made to the FMA under the FMC Act.

For purposes of this review, we also reviewed and considered documents and information provided to us including:

- corporate structure and governance arrangements
- minutes of select Board and committee meetings
- NZX's 'Market Assessment Report' setting out self-assessment of its compliance with market operator obligations
- NZ RegCo's 'Oversight and Engagement Report'
- the Tribunal's Annual Report 2021
- risk management framework
- various policies and procedures.

## Appendix 2: Ratings explained

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The following rating scale has been used to demonstrate the significance of our recommendations:

Rating	Definition
Low	Minor process or control issue identified, however unlikely to have had a material impact on the overall effectiveness of the systems and the entity's ability to comply with its obligations.
Medium	Process or control issue, with the potential to have a moderate impact on the overall effectiveness of the systems and the entity's ability to comply with its obligations.
High	Process or control issue requiring immediate attention that did, or may have, a significant effect on the overall effectiveness of the systems and the entity's ability to comply with its obligations, given its significance or systemic nature.

Action plans to implement changes should be prioritised by the rating of each finding with remediation of high-level findings requiring more immediate priority.

