

**IN NZ MARKETS DISCIPLINARY TRIBUNAL
SUMMARY HEARING PROCEDURE**

NZMDT 3/2015

UNDER the NZ Markets Disciplinary Tribunal Rules

IN THE MATTER OF breach of NZX Participant Rules 10.15.2 and 8.8.1

BETWEEN **NZX LIMITED**

AND **FIRST NZ CAPITAL SECURITIES LIMITED**
Respondent

**DETERMINATION OF NZ MARKETS DISCIPLINARY TRIBUNAL
22 APRIL 2015**



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1. This is a determination of a division of the NZ Markets Disciplinary Tribunal (*the Tribunal*) comprising Andrew Beck (division chairman), Shane Edmond and Christopher Swasbrook.
2. Capitalised terms that are not defined in this determination have the meanings given to them in the NZX Participant Rules (*the Rules*).

Background

3. First NZ Capital Securities Limited (*FNZ*) is an NZX Trading and Advising Firm and is subject to the Rules.
4. On 23 March 2015, NZX Limited (*NZX*) notified FNZ that it had decided to refer an alleged breach of Rules 10.15.2 and 8.8.1 to the Tribunal.
5. On 27 March 2015, NZX filed a statement of case (*SOC*) alleging a breach of Rules 10.15.2 and 8.8.1 by FNZ.
6. On 13 April 2015, FNZ filed a statement of response (*SOR*).
7. On 15 April 2015, NZX advised the Tribunal that it would not be filing a rejoinder.

Relevant Rules

8. Rule 10.15.2 requires that if a Trading Participant becomes aware that an Error has occurred in respect of a Trade and the Error may have a Market Impact, then the Trading Participant must notify NZX of the Error under Rule 10.15.1 immediately.
9. Under Rule 8.8.1, a Market Participant must ensure its conduct promotes and helps maintain an orderly market. This includes at all times observing Good Broking Practice.

Statement of Case

10. The SOC and annexures set out the following material facts:
 - a. On 28 July 2014:
 - i. a FNZ client placed an order through FNZ's Direct Market Access (*DMA*) system to sell 8,194 shares in an Issuer listed on the Main Board at the market price (*the Order*);
 - ii. the Order was stopped by FNZ's DMA filter, which was set to prevent trades that would cause a movement of more than 3% above or below the last traded price for that security;
 - iii. the Order was automatically redirected to the FNZ trading desk and was manually put through to market, in full, by an FNZ dealer;
 - iv. the Order resulted in six trades of 4,788 shares in total being executed at five different price levels with five different brokers involved. These trades resulted in the Issuer's ordinary share price dropping from the last traded price of \$3.13 to \$2.70 representing a 13.7% decline;
 - v. FNZ then cancelled the outstanding portion of the Order before the remaining 3,496 shares were traded;
 - vi. FNZ subsequently, through its Principal Account, placed four buy orders with one of these orders (1,000 shares at \$3.15) matching with a pre-existing client offer at that price.

- b. On 1 August 2014, FNZ deleted the three remaining buy orders it had placed on 28 July 2014. These buy orders were unfilled.
 - c. FNZ confirmed in subsequent correspondence with NZX that its dealer had clicked the full Order through to market in error.
 - d. FNZ did not notify NZX of the error immediately. The first contact the parties had in relation to the error was on 29 July 2014 when NZX wrote to FNZ to enquire about the events surrounding the Order.
11. NZX submitted that FNZ had breached Rule 10.15.2 by failing to immediately notify NZX when it became aware that an error had occurred which had a Market Impact. NZX argued that the error in this case had caused a Market Impact, as defined in the Rules, as the market price of the shares dropped from \$3.13 to \$2.70, a decline of 13.7%. NZX submitted that to measure the movement in the market price of a security, the relevant measure is the last traded price that was not the result of the order constituting an error, in this case \$3.13.
 12. NZX also submitted that FNZ had breached Rule 8.8.1 because it had failed to ensure that its conduct promoted and helped maintain an orderly market, and therefore did not observe Good Broking Practice.
 13. NZX submitted that the breach of the Rules in this case falls within penalty band 5 of Procedure 11.2.1 of the Tribunal Procedures, which applies to breaches of the Rules that are of a moderate nature and conduct that does not comply with Good Broking Practice. Under penalty band 5, a fine of up to \$50,000 is considered appropriate. NZX considers that the breach by FNZ falls within the lower end of penalty band 5.
 14. NZX submitted that the following mitigating factors are relevant in determining the appropriate penalty:
 - a. the error was unintentional; and
 - b. no clients were adversely affected.
 15. NZX submitted that the following aggravating factors are relevant in determining the appropriate penalty:
 - a. following the error, FNZ placed four bids for the Issuer's shares with the effect of restoring the market. In doing so, FNZ deprived NZX of the ability to exercise its discretion to cancel the trades or take any other remedial steps; and
 - b. from 28 September 2012 to 8 January 2013, FNZ had four breaches of Rules similar to Rule 10.15.2, none of which were deemed serious enough to warrant referral to the Tribunal.
 16. NZX has cited the Tribunal's decision in *NZMDT 3/2012 NZX v Craigs Investment Partners Ltd (Craigs Decision)* as a relevant precedent when considering the appropriate penalty to be imposed in this case.
 17. NZX submitted that the appropriate penalty was a public censure of FNZ, a fine of \$15,000, and an order that FNZ pay the costs of both NZX and the Tribunal. NZX noted that its costs incurred so far were \$3,200 (excluding GST).

Statement of Response

18. In the SOR, FNZ accepted NZX's reasons for:
 - a. calculating the movement in market price attributable to the error as being the last price unaffected by the error;
 - b. applying penalty band 5 in this case; and

- c. seeking a penalty towards the bottom end of the penalty band as the error was unintentional and without adverse effect on clients, but aggravated by FNZ's restoration of the market.
19. FNZ, however, disagreed with NZX's view that its previous breaches should be considered as an aggravating factor in this case. FNZ noted that the last of the breaches occurred over 18 months before this error, and should be viewed in the context of an error rate of 0.004% during that period. FNZ also noted NZX's comment that none were deemed serious enough to be referred to the Tribunal, illustrating their inapplicability to the present conduct.
20. FNZ also questioned the comparability of the *Craigs* Decision, noting that in that case there were two separate breaches giving rise to two separate market impacts, each much larger than in the present case. FNZ also noted that in this instance there was no technical deficiency or market disruption.

NZ Markets Disciplinary Tribunal Determination

21. FNZ has admitted making the error and has accepted that penalty band 5 should apply (albeit at the lower end of the band).
22. Accordingly, the Tribunal is simply required to determine the penalty that is to be imposed on FNZ for breaching the Rules.

Penalty

23. The requirement under Rule 10.15.2 to notify NZX immediately of an error where a market impact may have occurred is critical for NZX to ensure that a false market does not exist in relation to any security and that trading is conducted in a fair, orderly and transparent manner. Immediate notice of an error allows NZX to take prompt remedial action, if necessary, to minimise any impact on market participants and their clients.
24. The Tribunal is very concerned that FNZ failed to notify NZX of the error. FNZ's failure to do so meant that NZX was unable to formulate an appropriate regulatory response. This failure was further aggravated by FNZ's subsequent actions in seeking to restore the market itself. As noted in NZX's correspondence to FNZ, a decision to take corrective action in relation to any such error rests solely with NZX. The practice of market participants taking matters into their own hands has the potential to impact on market integrity and bring both the market and NZX into disrepute.
25. The Tribunal accepts FNZ's submission that errors are possible. However, the Tribunal is concerned that the circumstances in this case indicate that FNZ did not have adequate systems and procedures in place to manage any errors appropriately. The Tribunal also considers that FNZ needs to address its systems for dealing with orders that are caught by DMA filters.
26. NZX has submitted that the Tribunal should consider previous breaches of similar Rules by FNZ as an aggravating factor. The Tribunal is required under the Tribunal Rules to consider the conduct of the party to which a penalty will be imposed over the previous 24 month period. However, the Tribunal notes the submission from NZX that the previous breaches were not considered serious enough to warrant referral to the Tribunal and advice from FNZ that they should be viewed in the context of an error rate of 0.004% during that period.
27. The Tribunal has considered as mitigating factors that the error was unintentional and that no clients were adversely affected. The Tribunal also notes FNZ's advice to NZX in its letter of 8 December 2014 that it will ensure that it communicates promptly with NZX in any such future error situation before acting.

28. The Tribunal has reviewed the *Craigs* decision. In that case, the Tribunal considered two separate instances of breach – one which occurred while the DMA system was without filters and the other where the filters were in place but an unintentional error was nevertheless made. Both breaches resulted in significant market disruption. The Tribunal agrees with FNZ that these breaches are more serious than the current instance which did not result in market disruption and where FNZ had adequate DMA filters in place. However, FNZ sought to restore the market itself, a factor not present in the *Craigs* case. The Tribunal also notes that the \$10,000 penalty ordered in respect of the second less serious breach was cumulative with the \$35,000 penalty imposed in respect of the first breach.
29. Having considered the circumstances of this case, the Tribunal agrees with the parties that the breaches fall at the low end of penalty band 5. Accordingly, the Tribunal considers that a penalty of \$15,000 is appropriate in this case. The penalty is intended to send a clear message that self-correction of errors by market participants is unacceptable.


Public Censure

30. NZX has sought a penalty of public censure. The Tribunal considers that the public naming of FNZ is entirely appropriate in this case given the penalty band into which the conduct falls.

Orders

31. The Tribunal orders that FNZ:
- a. is publicly censured in the form of the announcement attached to this decision;
 - b. pay \$15,000 to the NZX Discipline Fund;
 - c. pay the costs and expenses incurred by the Tribunal in considering this matter;
and
 - d. pay the costs and expenses incurred by NZX in considering this matter.
32. The Tribunal recommends that this decision be released to the market in full under Tribunal Rule 6.6.

DATED 22 APRIL 2015



Andrew Beck, Division Chairman, NZ Markets Disciplinary Tribunal



[x] 2015

ANNOUNCEMENT OF NZ MARKETS DISCIPLINARY TRIBUNAL

PUBLIC CENSURE OF FIRST NZ CAPITAL SECURITIES LIMITED BY THE NZ MARKETS DISCIPLINARY TRIBUNAL FOR A BREACH OF NZX PARTICIPANT RULES 10.15.2 AND 8.8.1

1. In a determination of the NZ Markets Disciplinary Tribunal (*the Tribunal*) dated 22 April 2015, the Tribunal found that First NZ Capital Securities Limited (*FNZ*) breached NZX Participant Rules (*Rules*) 10.15.2 and 8.8.1.

Background

2. First NZ Capital Securities Limited (*FNZ*) is an NZX Trading and Advising Firm and is subject to the Rules.
3. On 28 July 2014, FNZ entered an order into the trading system in error which resulted in a market impact on the securities of an Issuer. FNZ failed to notify NZX of the error and sort to restore the market itself.
4. FNZ breached Rule 10.15.2 by failing to immediately notify NZX of the error and as a result also breached Rule 8.8.1.

Determination

5. The requirement under Rule 10.15.2 to notify NZX immediately of an error where a market impact may have occurred is critical for NZX to ensure that a false market does not exist in relation to any security and that trading is conducted in a fair, orderly and transparent manner. Immediate notice of an error allows NZX to take prompt remedial action, if necessary, to minimise any impact on market participants and their clients.
6. The Tribunal is very concerned that FNZ failed to immediately notify NZX of its error. FNZ's failure to do so meant that NZX was unable to formulate an appropriate regulatory response. This failure was further aggravated by FNZ's subsequent actions in seeking to restore the market itself. A decision to take corrective action in relation to such a trading error rests solely with NZX. The practice of market participants taking matters into their own hands has the potential to impact on market integrity and bring both the market and NZX into disrepute.
7. The Tribunal accepts that errors are possible. However, the Tribunal is concerned that the circumstances in this case indicate that FNZ did not have adequate systems and procedures in place to manage any errors appropriately.
8. The Tribunal has considered as mitigating factors that the error was unintentional and that no clients were adversely affected. The Tribunal also noted FNZ's advice that it will ensure that it communicates promptly with NZX in any such future error situation before acting.

Penalties

9. The Tribunal orders that FNZ:
 - a. is publicly censured in the form of this announcement;
 - b. pay \$15,000 to the NZX Discipline Fund;
 - c. pay the costs and expenses incurred by the Tribunal in considering this matter;
and
 - d. pay the costs and expenses incurred by NZX in considering this matter.

Censure

10. The Tribunal hereby publicly censures FNZ for its breach of Rules 10.15.2 and 8.8.1.

The Tribunal

11. The Tribunal is a disciplinary body which is independent of NZX and its subsidiaries. The Financial Markets Authority approves its members. Under the Tribunal Rules, the Tribunal determines and imposes penalties for referrals made to it by NZX in relation to the conduct of parties regulated by the market rules.

Dated [x] 2015