



Futures Contracts (NZCDC Settlement System and NZX Derivatives Market) Exemption Notice 2010

Pursuant to section 48(1)(d) of the Securities Markets Act 1988, the Securities Commission gives the following notice (to which is appended a statement of reasons of the Securities Commission).

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Notice

1 Title

This notice is the Futures Contracts (NZCDC Settlement System and NZX Derivatives Market) Exemption Notice 2010.

2 Commencement

This notice comes into force on the day after the date of its notification in the *Gazette*.

3 Expiry

This notice expires on the close of 30 November 2015.

4 Interpretation

(1) In this notice, unless the context otherwise requires,—

Act means the Securities Markets Act 1988

AFS licence means an Australian financial services licence granted under the Corporations Act, which allows the clearing participant or the derivatives participant to advise retail and wholesale clients on, and to deal on behalf of retail and wholesale clients in, derivatives contracts, including futures contracts

clearing participant means a participant in the NZCDC settlement system that participates in the clearing house, but does not include NZ Clearing

Corporations Act means the Corporations Act 2001 of the Commonwealth of Australia

Corporations Regulations means the Corporations Regulations 2001 of the Commonwealth of Australia

C&S Rules means NZ Clearing's Clearing and Settlement Rules, which are part of the rules of the NZCDC settlement system

depository operating rules means NZ Depository's Depository Operating Rules, which are part of the rules of the NZCDC settlement system

depository participant means a participant in the NZCDC settlement system that participates in the depository, but does not include NZ Depository

derivatives contract has the same meaning as in the Derivatives Market Rules of the NZX derivatives market and in the C&S Rules

derivatives participant means a participant in the NZX derivatives market that holds client money or client property

NZ Clearing means New Zealand Clearing Limited, which is a wholly owned subsidiary of NZCDC and the specified operator of, and a participant in, the NZCDC settlement system

NZ Depository means New Zealand Depository Limited, which is a wholly owned subsidiary of NZCDC and an operator of, and a participant in, the NZCDC settlement system

NZCDC means New Zealand Clearing and Depository Corporation Limited, a wholly owned subsidiary of NZX Limited

NZCDC settlement system means the settlement system owned by, and operated and managed by or on behalf of, NZCDC that is declared to be a designated settlement system pursuant to section 156N of the Reserve Bank of New Zealand Act 1989

NZX derivatives market means the futures market in respect of which NZX Limited is authorised by the Securities Commission under Part 3 of the Act as an authorised futures exchange

Regulations means the Futures Industry (Client Funds) Regulations 1990

segregated derivatives market client funds settlement account means a segregated derivatives market client funds settlement account required by rule 2.21.4 of the C&S Rules

specified participant means a person that is both a clearing participant and a depository participant.

- (2) Any term or expression that is defined in the Act or the Regulations and used, but not defined, in this notice has the same meaning as in the Act or the Regulations.

5 Exemption for specified participants and derivatives participants from all of Regulations

Every specified participant, every derivatives participant, and every person acting on behalf of any of them are exempted from compliance with all of the Regulations.

6 Conditions of exemption in clause 5

The exemption in clause 5 is subject to the conditions that the specified participant or the derivatives participant, as the case may be,—

- (a) must hold a current AFS licence and must have provided a copy of that AFS licence to the Securities Commission; and
- (b) must hold all of its client funds in a segregated client funds account in accordance with the provisions of its AFS licence, the Corporations Act, and the Corporations Regulations in relation to the protection of client money and client property; and
- (c) must maintain proper records, which are audited or reviewed, and reported on, in accordance with its AFS licence, the Corporations Act, and the Corporations Regulations, that—
 - (i) record dealings with clients in respect of futures contracts; and
 - (ii) record client money or client property received, held, or otherwise dealt with in connection with dealings in respect of futures contracts; and
- (d) must send a copy of its audited financial statements to the Securities Commission not more than 3 months after the end of each of its financial years; and
- (e) must maintain, and participate in, an external disputes resolution scheme that is available to New Zealand retail clients; and
- (f) must notify the Securities Commission in writing if—
 - (i) the specified participant or derivatives participant becomes insolvent; or
 - (ii) a receiver, provisional liquidator, liquidator, or similar officer is appointed, or any resolution is passed or order is made for the liquidation or dissolution of the specified participant or derivatives participant; or
 - (iii) the specified participant or derivatives participant, or any of its directors or senior managers, is convicted of an indictable offence; or

- (iv) any auditor's report prepared in accordance with the Corporations Act or the Corporations Regulations in accordance with the specified participant's or derivatives participant's AFS licence shows any non-compliance with any of the Corporations Act, the Corporations Regulations, or the AFS licence; or
- (v) any regulatory action is taken against the specified participant or derivatives participant, or any of its directors or senior managers, whether in New Zealand or elsewhere; or
- (vi) the specified participant's or derivatives participant's AFS licence is varied or revoked.

7 Exemption for NZ Depository from dealer provisions of Regulations

- (1) NZ Depository and every person acting on its behalf are exempted from compliance with regulations 3 to 10, 11(1), 12, 14, 15, 16(1), 17 to 19, and 22 to 24 of the Regulations.
- (2) The exemption in this clause applies only if NZ Clearing has required, pursuant to rule 2.21.4 of the C&S Rules, each specified participant to segregate into a segregated derivatives market client funds settlement account the following transactions:
 - (a) transactions in derivatives contracts that are cleared and settled by that specified participant on behalf of a customer (as defined in the C&S Rules); and
 - (b) transactions in any other derivatives contracts that are entered into by the specified participant other than on its own account.

8 Condition of exemption in clause 7 (with effect of treating NZ Depository as if it were clearing house)

The exemption in clause 7 is subject to the condition that NZ Depository must, as if it were both a clearing house for a futures exchange and a recognised clearing house (as defined in the Regulations),—

- (a) provide written statements in forms 3 and 4 of the Regulations in accordance with regulations 10 and 15 of the Regulations, except that the written statements—

- (i) may acknowledge that set-offs may be made in accordance with rule 7.8 of the C&S Rules; and
- (ii) may include the acknowledgment to be provided under clause 10(2)(c) of this notice; and
- (b) comply with regulation 13(b)(i) of the Regulations as if it permitted NZ Depository to debit from a specified participant's client funds account amounts for, or in connection with, the entering into, margining, or settling of derivatives contracts on behalf of clients of the specified participant in respect of which the account is maintained; and
- (c) comply with regulations 20 and 21 of the Regulations (subject to the way that compliance with those regulations is varied, in terms of regulations 13 and 20 of the Regulations, by paragraph (b) and clause 11 of this notice); and
- (d) comply with regulation 11(2), the rest of regulation 13, and regulation 16(2) and 16(3) of the Regulations.

9 Exemption for specified participants consequential on exemption for NZ Depository in clause 7

- (1) Every specified participant and every person acting on its behalf are exempted from regulations 9(1)(a), 10(1), 11(1), 12, 14, and 16(1) of the Regulations to the extent necessary to permit the person to deal with NZ Depository as if NZ Depository (in addition to NZ Clearing) were both a clearing house for a futures exchange and a recognised clearing house (as defined in the Regulations).
- (2) This clause applies only if—
 - (a) NZ Clearing has required, pursuant to rule 2.21.4 of the C&S Rules, the specified participant to open a segregated derivatives market client funds settlement account; and
 - (b) NZ Depository has provided the written statements described in clause 8(a) of this notice to the specified participant.

10 Condition of exemption in clause 9 (with effect of allowing specified participants to deal with NZ Depository as if it were clearing house)

- (1) The exemption in clause 9 is subject to the condition that the specified participant must comply with the Regulations in its dealings with NZ Depository as if NZ Depository (in addition to NZ Clearing) were both a clearing house for a futures exchange and a recognised clearing house (as defined in the Regulations) and with the modifications set out in subclause (2).
- (2) The modifications are—
 - (a) that the obligation in regulation 8(1)(a) and (f) of the Regulations must be read as if it permitted the specified participant to make payments out of a client bank account on behalf of a client—
 - (i) for, or in connection with, the entering into, margining, or settling of a derivatives contract on behalf of the client of the specified participant entitled to the money; and
 - (ii) to meet the amount of any fees, commissions, or other charges properly payable by a client to the specified participant in respect of any dealing in derivatives contracts on behalf of the client; and
 - (b) that the obligation in regulation 10(1)(d) of the Regulations must be read as if it permitted the specified participant to accept an acknowledgment from NZ Depository referred to in clause 8(a) of this notice; and
 - (c) that regulation 11(1) of the Regulations must be read as if it imposed an obligation on NZ Depository to provide an acknowledgment to the specified participant that all money that NZ Depository receives from the specified participant for crediting to that account is client money, rather than an obligation on the specified participant to instruct NZ Clearing and NZ Depository each time that money is deposited into a segregated derivatives market client funds settlement account; and
 - (d) that the obligation in regulation 12(b)(i) of the Regulations must be read as if it permitted the specified participant to authorise amounts to be debited to a client

funds account for amounts of any payments made for, or in connection with, the entering into, margining, or settling of derivatives contracts on behalf of the client of the specified participant in respect of which the account is maintained.

11 Exemption for NZ Depository from regulation 20(3)(b)(ii) of Regulations

- (1) NZ Depository and every person acting on its behalf are exempted from regulation 20(3)(b)(ii) of the Regulations in respect of any money credited to a segregated derivatives market client funds settlement account in respect of any amount—
 - (a) that is owed to a specified participant; and
 - (b) that rule 7.8 of the C&S Rules permits NZ Clearing to set off.
- (2) This clause applies only if NZ Clearing—
 - (a) has required, pursuant to rule 2.21.4 of the C&S Rules, the specified participant to open a segregated derivatives market client funds settlement account; and
 - (b) exercises its right to set-off under rule 7.8 of the C&S Rules only—
 - (i) in respect of obligations owed by the specified participant to NZ Clearing in respect of the segregated derivatives market client funds settlement account; and
 - (ii) against obligations owed by NZ Clearing to the specified participant in respect of the segregated derivatives market client funds settlement account.

12 Exemption for derivatives participants from regulation 8(1)(a) and (f) of Regulations

Every derivatives participant and every person acting on its behalf are exempted from regulation 8(1)(a) and (f) of the Regulations to the extent that those paragraphs prevent the derivatives participant from making payments out of a client bank account on behalf of a client—

- (a) for, or in connection with, the entering into, margining, or settling of a derivatives contract on behalf of

- the client of the derivatives participant entitled to the money; or
- (b) to meet the amount of any fees, commissions, or other charges properly payable by a client to the derivatives participant in respect of any dealing in derivatives contracts on behalf of the client.

Dated at Wellington this 6th day of September 2010.

The Common Seal of the Securities Commission was affixed in the presence of:

[Seal]

David Mayhew,
Member.

Statement of reasons

This notice comes into force on the day after the date of its notification in the *Gazette* and expires on 30 November 2015.

The notice exempts various parties from the Futures Industry (Client Funds) Regulations 1990 (the **CFR**) in respect of NZX's new settlement system and derivatives market.

There are 3 main types of exemptions as follows:

- an exemption for derivatives participants and specified participants that operate under the terms of a current Australian financial services licence;
- an exemption in respect of NZ Depository from the dealer provisions of the CFR, on the basis that NZ Depository complies with those CFR regulations applying to a recognised clearing house and a clearing house for a futures exchange. The

effect is that NZ Depository must provide the acknowledgments under regulations 10 and 15 (as set out in forms 3 and 4, respectively) and comply with regulations 11(2), 13, 16(2), 16(3), 20, and 21 of the CFR:

- exemptions for specified participants, NZ Depository, and derivatives participants from compliance with various other regulations of the CFR, to the extent that these regulations are inconsistent with the derivatives market rules, the C&S Rules, the clearing and settlement procedures, the depository operating rules, the depository operating procedures, and the operations of the system.

The Securities Commission considers that it is appropriate to grant the first type of exemption because—

- the persons benefiting from the exemptions will already be carrying on business in Australia and will be subject to regulation by the Australian Securities and Investments Commission. The exemptions will allow those entities to carry on business in respect of their New Zealand clients under the same rules as apply in respect of their Australian clients; and
- the requirements of Australian law in respect of client money and client property are broadly equivalent to those under the CFR, and provide adequate protection for a New Zealand client's assets.

The Securities Commission considers that it is appropriate to grant the second type of exemption because—

- NZ Depository forms an integral part of the system to be used to settle derivatives contracts. NZ Depository will hold client assets and funds for the purposes of settlement:
- NZ Depository has been authorised to deal in futures contracts for the purpose of, or in connection with, the operation of a designated settlement system:
- by the granting of the exemptions, NZ Depository is subject to an appropriate regulatory framework to the extent that it is handling client funds:
- by the granting of the exemptions that permit specified participants to treat NZ Depository as though it were a clearing house for the purposes of the CFR, client money and property will be afforded the protections that the CFR anticipate will

be provided during the course of settlement and margining of futures contracts.

The Securities Commission considers that it is appropriate to grant the third type of exemption because—

- each of the exemptions sought is technical in nature and the conditions imposed ensure that the underlying policy of the CFR is not infringed;
- the settlement system is designated under Part 5C of the Reserve Bank of New Zealand Act 1989;
- underlying clients are afforded protections by the extension of the CFR to derivatives contracts.

The Securities Commission is satisfied that these matters provide adequate alternative safeguards for preserving client money and client property.

Issued under the authority of the Acts and Regulations Publication Act 1989.
Date of notification in *Gazette*: 9 September 2010.
This notice is administered by the Securities Commission.
