



Guidance Note

Eligibility to trade on the NXT Market

February 2015

The purpose of this guidance note is to provide guidance to NZX Trading and Advising Firms and NZX Advising Firms as to NZX’s expectations in relation to the pre-trade process for retail clients set out in the NZX Participant Rules. This guidance note includes information on the definition of “retail client” and an explanation of the types of evidence required to demonstrate a retail client’s eligibility to trade on NXT.

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This guidance note is not intended to be a definitive statement of the application of the NZX Participant Rules in every situation, and is only a guide to NZX’s policy and practices. This guidance note is not legal advice and does not limit NZX’s discretion under the NZX Participant Rules. This guidance note reflects the NZX Participant Rules and law as at February 2015, which are subject to change. NZX takes no responsibility for any error contained in this guidance note. NZX may replace guidance notes at any time and NZX Participants should ensure that they have the most recent version of this guidance note by checking the NXT website at nxt.co.nz

1. Introduction

NXT has been designed as a platform to provide small to mid-sized companies, who are typically at an earlier stage of business development, with access to capital. NXT differs from NZX's other markets in that it operates under a different disclosure framework and there is uncertainty as to the level of liquidity on NXT. Accordingly, the risks associated with investing on NXT may be higher than investing in other companies.

This note provides guidance for NZX Trading and Advising Firms and NZX Advising Firms as to NZX's expectations in relation to the pre-trade process for retail clients set out in the NZX Participant Rules ("**rules**").

Appendix 1 to this guidance note sets out the pre-trade process requirements contained in rule 23.1.

2. General Obligations

Participants will need to comply with the know your client and duty of care provisions of the rules and meet the usual requirements in relation to dealing with clients, including anti-money laundering and client on-boarding processes.

3. When is evidence of eligibility to trade required?

3.1 If your client is a retail client

NZX Trading and Advising Firms or NZX Advising Firms must hold evidence that a retail client is eligible to trade on the NXT Market before executing a buy order for that client. A retail client is a client who is a retail investor within the meaning of clause 35(1) of Schedule 1 of the Financial Markets Conduct Act ("**FMCA**") (refer to rule 23.1).

The FMCA defines a **retail investor** as a person who is not a wholesale investor in relation to the offer or service.

A **wholesale investor** is defined as:

- a person who is in an **investment business**;
- a person who meets the **investment activity criteria**;
- a person who is **large**;
- a person who is a **government agency**; or
- a person who is an **eligible investor**.

Participants should refer to the FMCA for the definitions of the terms in bold above.

Evidence of eligibility must be held in respect of every retail client who places an order to buy securities quoted on the NXT Market. Participants should consider whether their client, rather than the person placing the order, is a retail client and therefore whether evidence of eligibility is required.

For example, where a person trades on behalf of a client who is a wholesale investor, no evidence of eligibility is required. However, Participants should follow their usual processes to ensure that person has appropriate authority to trade on behalf of the entity. Where a person trades on behalf of a client who is a retail investor, a Participant must obtain evidence that the underlying retail client is eligible to trade on NXT.

3.2 If your retail client wishes to buy a security quoted on NXT

A NZX Trading and Advising Firm or NZX Advising Firm is only required to hold evidence of a client's eligibility to trade on NXT Market in respect of a buy order. The rules do not require evidence of eligibility to be held in respect of a sell order.

3.3 If you do not already hold evidence of your retail client's eligibility to trade on NXT

A NZX Trading and Advising Firm or NZX Advising Firm is only required to obtain evidence of eligibility to trade once in respect of each retail client. Where evidence of eligibility is already held in respect of a particular retail client, new evidence is not required where that client wishes to acquire shares in the same or another NXT company at a later time.

Firms should note that some retail investors may hold shares in a NXT company without having gone through the pre-trade process. For example, a retail investor who purchased shares in a NXT company before the company listed on the NXT Market (including by way of subscription in a NXT company's initial public offer). Participants must therefore obtain evidence of eligibility to trade if such investors wish to acquire further shares in a NXT company or shares in another NXT company.

4. What is evidence of eligibility to trade?

Rule 23.1.2(b) sets out what constitutes evidence of a retail client's eligibility to trade on the NXT Market.

Evidence that a retail investor is eligible to trade on NXT Market is either:

- confirmation from the client that the client has received a copy of the NXT Warning and understands the NXT Warning; or
- a record of the client's NZX Reference Number.

Both of these forms of evidence involve the retail client reading and understanding the NXT Warning.

4.1 The NXT Warning

The NXT Warning is a statement (which is set out in Procedure 4.1 of the NZX Participant Rule Procedures):

The NXT Market ("NXT") is a registered market operated by NZX Limited that is designed for smaller companies that are typically at an earlier stage of business development and

accordingly, the risks of investing in companies listed on NXT may be higher than investing in other companies.

Under the NXT Market Rules, NXT companies are required to immediately disclose information concerning specific events prescribed in the NXT Market Rules, however it is possible that some price sensitive information may not be required to be disclosed, and therefore you could trade on NXT without the benefit of all price sensitive information in relation to a NXT company. The NXT Market Rules require NXT companies to have an insider trading policy and insider trading law applies to anyone trading on the NXT Market.

NZX has appointed market makers and research providers for NXT, however, there is uncertainty as to the level of liquidity on NXT, which may impact upon your ability to buy or sell shares when you want to.

The NXT Warning is also required to be included prominently on the front page of a NXT Listing Document and will also be displayed on the NXT website: nxt.co.nz.

NZX Trading and Advising Firms and NZX Advising Firms will need to develop a process to ensure that the retail investors who they advise, have read and understood the risk warning, and that evidence of this is maintained.

4.2 Confirmation that the client has received a copy of the NXT Warning and understands the NXT Warning

One way a Participant can obtain evidence that a retail client is eligible for trading on NXT is to obtain confirmation from the client that the client has received a copy of the NXT Warning and understands the NXT Warning.

The process for evidencing eligibility could involve investors acknowledging that they have read and understand the NXT Warning as part of the Participant's account opening process. To meet the requirement of the rules, a Participant must expressly draw the NXT Warning to their client's attention and ensure that their client has read and understands the NXT Warning.

NZXR notes that merely including the NXT Warning in the Participant's standard terms and conditions or client agreement will not meet the requirement of the rules. Participants must provide the NXT Warning to a retail client in a clear and distinct manner that is separate from any standard terms and conditions and to obtain a specific sign-off from their client that the client has read and understands the NXT Warning.

4.3 A record of the client's NZX Reference Number

Another way a Participant can obtain evidence that a retail client is eligible to trade on NXT is to record the client's NZX Reference Number.

A NZX Reference Number is a number generated by NZX on completion of NZX's online process. That process involves the user being provided with the NXT Warning and requires the user's confirmation that they understand the NXT warning.

NZX will provide the NZX Reference Number to each user directly following completion of the online process. NZX Participants should confirm with their client as to whether the client has a NZX Reference Number. If the client does have a NZX Reference Number, the Participant can ask the client to provide their NZX Reference Number for verification by the Participant.

A NZX Participant can verify a client's NZX Reference Number at:
https://www.nxt.co.nz/pages/verify_reference_number_page

4.4 Reliance on evidence of eligibility

Where a NXT Trading and Advising Firm receives an instruction from a NZX Advising Firm to execute a buy order, the NXT Trading and Advising Firm should ensure that they hold evidence of the client's eligibility to trade on the NXT Market prior to executing the buy order. NZX would expect a NZX Advising Firm to confirm a retail client's eligibility to trade before instructing a NZX Trading and Advising Firm to execute the trade and that NZX Trading and Advising Firm is entitled to rely on that evidence.

5. Requirement to maintain evidence

The pre-trade process requires Participants to hold evidence of a retail investor's eligibility to trade. In accordance with rule 3.27, a Participant must maintain these records for seven years and these records must be available for inspection, following a request from NZX.

Appendix 1 – NZX Participant Rule 23.1

23.1 NXT WARNING

23.1.1 Before a NZX Trading and Advising Firm or NZX Advising Firm executes an Order from a retail client to purchase a security Quoted on NXT Market, that NZX Trading and Advising Firm or NZX Advising Firm must hold evidence that the retail client is eligible to trade on NXT Market.

23.1.2 For the purposes of Rule 23.1.1:

- a. a retail client is a client who is a retail investor within the meaning of clause 35(1) of Schedule 1 of the Financial Markets Conduct Act 2013; and
- b. evidence that a retail client is eligible to trade on NXT Market is confirmation from the client that the client has received a copy of the NXT Warning and understands the NXT Warning, or a record of the client's NZX Reference Number; and
- c. an NZX Reference Number is a number generated by NZX on completion of NZX's online process that provides the user with the NXT Warning and requires the user's confirmation that they understand the NXT Warning; and
- d. the NXT Warning is a statement in the form set out in Procedure.