

20 March 2015

**APPLICATION FOR WAIVERS FROM NZX MAIN BOARD LISTING RULES  
SMARTSHARES LIMITED**

1. This is a decision of the Special Division of the NZ Markets Disciplinary Tribunal (*Special Division*).
2. Capitalised terms that are not defined in this decision have the meanings given to them in the NZX Main Board Listing Rules (*the Rules*).

**Background**

3. Smartshares Limited (*Smartshares*) is the manager of several exchange traded funds (*ETFs*) with units Quoted on the NZX Main Board (*GIF Funds*). Smartshares is a wholly owned subsidiary of NZX Limited (*NZX*) and accordingly, its listing is regulated by the Special Division.
4. In December 2014, Smartshares established two new index tracking unit trusts - the Australian Property Index Trust and the Australian Dividend Index Trust (*2014 Trusts*). Units in the 2014 Trusts are Quoted on the NZX Main Board. On 4 December 2014, the Special Division granted a number of waivers and approvals under the Rules in respect of the 2014 Trusts. A copy of that decision is available at <https://nzx.com/regulation/DISP/announcements>.
5. Smartshares intends to offer units in three new index tracking unit trusts - the New Zealand Dividend Index Trust, the Australian Financials Index Trust and the Australian Resources Index Trust (*the Trusts*). Units in the Trusts will be Quoted on the NZX Main Board. Each Trust will be an exchange traded fund and will be identical in nature and structure to the 2014 Trusts.
6. Each Trust is a unit trust established under an establishment deed and a master trust deed (*the Trust Deeds*). The beneficial interest in each Trust is divided into units with each unit representing an equal interest in the assets of the Trust, but not conferring any interest in any specific asset of the Trust.
7. Each Trust is a passive investment fund which tracks a specific index. Under the terms of the Trusts, Smartshares must track the performance of each Trust's associated index which it does by buying and selling the securities of the issuers which comprise each index in proportion to their respective weighting in the index. These securities (which constitute the Trusts' assets) are then held by each Trust's custodian on behalf of the trustee of the Trusts (*the Trustee*).
8. Smartshares intends to lend the securities held by the New Zealand Dividend Index Trust (*Trust Securities*) through the central counterparty clearing and settlement system (*CSS*) operated by entities which are Related Parties of Smartshares on the same basis as currently undertaken in respect of the GIF Funds which track New Zealand indices. On 2 September 2010, the Special Division granted waivers under the Rules for securities lending in respect of the GIF Funds. A copy of that decision is attached.

### **Application 1 - On-going Waivers and Approval**

9. Smartshares has applied, as manager of the Trusts, for waivers from Rules 3.1.1(a), 3.1.1(b), 3.3.1(c) to 3.3.4, 3.3.5 to 3.3.15, 3.4, 3.5, 3.6.2(a) and 3.6.2(c), Section 4, 7.1.11, 7.3, 7.4, 7.5, 7.6.1 to 7.6.3, 9.1.1, 9.2.1, 10.3.2, 10.4.1(b), 10.4.2 and 10.6.1(a) and for approval under Rule 11.1.5. A copy of Smartshares' application is attached to this decision.
10. Smartshares submitted that because the Rules treat units in a unit trust as Equity Securities, a number of the Rules to which a waiver is sought are either inapplicable or unnecessary.
11. Smartshares also noted that the Special Division has previously granted waivers from these Rules and approval under Rule 11.1.5 in respect of the GIF Funds.

### **Application 1 - Decision**

12. On the basis that the information provided to the Special Division is full and accurate in all material respects, the Special Division grants Smartshares as manager of the Trusts:
  - a. waivers from the Rules noted in Appendix 1 subject to the conditions set out in Appendix 2; and
  - b. approval under Rule 11.1.5 for the inclusion in the Trust Deeds of provisions that restrict the issue, acquisition or transfer of units to allow each Trust to comply with the Portfolio Investment Entity (*PIE*) regime.

### **Application 1 - Reasons**

13. In coming to the decision to grant Smartshares waivers from the Rules noted in Appendix 1 (subject to the conditions set out in Appendix 2), the Special Division considered:
  - a. that the Rules were drafted with company structures in mind and some of the Rules are either not applicable to the Trusts or do not provide the protections to investors that they are intended to provide;
  - b. the nature of the Trusts as passively managed index tracking unit trusts. The Special Division noted that the Directors of Smartshares do not exercise influence over the Trusts in the same way or to the same extent as do Directors of an Issuer who is a company. Smartshares must operate the Trusts in accordance with its investment objective – to buy and sell securities in order to track the relevant index;
  - c. the provisions of the Trust Deeds and the responsibilities of the Trustee, as disclosed in the offer documents, which protect the interests of the Trusts' unitholders;
  - d. that the conditions set out in Appendix 2 would ensure that where the provisions of a Rule are not applicable to the Trusts, the Rule's intent could still be achieved; and
  - e. that it has previously granted waivers from the same Rules for the 2014 Trusts and the GIF Funds.
14. In coming to the decision to grant Smartshares approval under Rule 11.1.5, the Special Division considered:
  - a. the submission from Smartshares that the majority of investors in the Trusts would benefit from investing in a PIE compliant entity;
  - b. the PIE thresholds will be clearly disclosed in the offer documents;
  - c. given the passive nature of the Trusts, the PIE thresholds are unlikely to be triggered; and
  - d. that it has previously granted approval under this Rule for the 2014 Trusts and the GIF Funds.

## Application 2 - Waivers for Quotation

15. Smartshares has applied, as manager of the Trusts, for waivers from Rules 5.2.1 and 5.2.3 in respect of the Quotation of the units in the Trusts.
16. Rule 5.2.1 requires an Issuer applying for Quotation of a new class of security to apply through an Organising Participant, except where the application relates to rights in respect of securities that are already quoted. Smartshares has submitted that the requirement for an Organising Participant is aimed at:
  - a. ensuring a new Issuer has received appropriate advice and guidance from a regulated capital markets practitioner before offering securities for the first time to the public; and
  - b. encouraging adequate liquidity post listing via distribution to the institutional and retail network of the Organising Participant.
17. In support of its application for a waiver from Rule 5.2.1, Smartshares submitted that:
  - a. the advice of an Organising Participant is not needed to develop and launch the Trusts. Smartshares is already manager for the 2014 Trusts, the GIF Funds and one unlisted fund, and has operated ETFs in New Zealand since 1996. Expert capital markets advice regarding a new listing does not therefore deliver any benefits to Smartshares that could typically be expected of a company coming to market for the first time;
  - b. it does not need an Organising Participant to assist with the distribution of the units in the Trusts in the traditional sense. The initial investment in the Trusts will be made under an arrangement with SuperLife Superannuation Scheme (*the Scheme*), whose manager SuperLife Limited was recently acquired by NZX, and after the initial Quotation, additional investment in the Trusts will be sought in the same way as additional investment is sought in relation to the GIF Funds. Smartshares has already engaged a seed partner to invest approximately \$20 million in each Trust, which is of a sufficient scale for the Trusts to be launched without further pre-listing distribution. In other instances, pre-listing distribution may be necessary for a fund to reach a sufficient scale before it is Listed. The distribution capability of an Organising Participant is therefore not necessary or beneficial in launching the Trusts; and
  - c. to require Smartshares to appoint an Organising Participant would add little value to the process, but would require Smartshares to incur additional cost.
18. Rule 5.2.3 states that a class of securities will generally not be considered for Quotation unless the spread requirements are met, or NZX is otherwise satisfied that the Issuer will maintain a spread of security holders which is sufficient to ensure that there is a sufficiently liquid market in the class of securities.
19. Smartshares has advised the Special Division that the Trusts will not meet the spread requirements because the seed funding for each Trust (approximately \$20 million) will come from the Scheme. The Scheme has approximately 45,000 members (although these numbers fluctuate with normal member movements and Scheme members can choose among a number of asset pools for their investment and may alter the allocation at their discretion). This results in frequent movements between asset classes (for example, shifting money out of NZ shares and into fixed interest or vice versa), which will have a corresponding impact on Trust liquidity as the Scheme will be required to trade to respond to members changing between asset pools.
20. In support of its application for a waiver from Rule 5.2.3, Smartshares submitted that:
  - a. given its experience in relation to the 2014 Trusts and the GIF Funds, Smartshares expects that the number of new investors in the Trusts, and liquidity, will increase over time. There are over 8,860 investors in the 2014 Trusts and the GIF Funds, 27% of which hold units in more than one of these funds, so there is an expectation

that listing new funds will see growth from existing Smartshares investors wanting access to a broader range of listed funds in New Zealand.;

- b. unlike other listed equity instruments, liquidity in ETFs is not influenced only by demand for the ETFs themselves, but also liquidity in the underlying assets (securities) held by the ETF. This underlying liquidity is augmented by the presence of an informal market maker, whose role is designed to give investors confidence when buying or selling units in the ETFs; and
- c. Smartshares has increased the marketing spend for its ETFs and expects this to further develop liquidity.

#### **Application 2 - Decision**

- 21. On the basis that the information provided to the Special Division is full and accurate in all material respects, the Special Division grants Smartshares as manager of the Trusts waivers from Rules 5.2.1 and 5.2.3.

#### **Application 2 – Reasons**

- 22. In coming to the decision to grant Smartshares waivers from Rules 5.2.1 and 5.2.3, the Special Division considered that:
  - a. Smartshares has the requisite expertise in relation to ETFs such that it does not need the guidance of an Organising Participant to assist with Listing the new Trusts;
  - b. given Smartshares has an arrangement with the Scheme under which it will invest approximately \$20 million in each Trust, the distribution capability of an Organising Participant is not necessary or beneficial in launching the Trusts;
  - c. it has previously granted a waiver from these Rules for the 2014 Trusts and that NZX Regulation has previously granted waivers from Rule 5.2.1; and
  - d. given the measures Smartshares has outlined above and developments in respect of the 2014 Trusts and the GIF Funds, liquidity in the units of the Trusts is likely to develop.

#### **Publication**

- 23. This decision is confidential until such time as the prospectus for the offer of units in the Trusts is registered. Following registration this decision will be published in accordance with Rule 1.11.2.

DATED 20 MARCH 2015



Andrew Beck, Chairman, Special Division

## **APPENDIX 1**

Rules 3.1.1(a), 3.1.1(b), 3.3.1(c) to 3.3.4, 3.3.5 to 3.3.15, 3.4, 3.5, 3.6.2(a) and 3.6.2(c)

Section 4: Takeovers

Rules 7.1.11, 7.3, 7.4, 7.5 and 7.6.1 to 7.6.3

Rules 9.1.1 and 9.2.1

Rules 10.3.2, 10.4.1(b), 10.4.2 and 10.6.1(a)

## **APPENDIX 2**

The conditions of the waivers granted from the Rules noted in Appendix 1 of this decision are:

1. The nature of the Trusts' business and operations do not materially change.
2. The waivers granted in this decision and these conditions are noted in the Trusts' half year and annual reports.

### **Audit Committee**

3. Each Trust must have an Audit Committee.
4. The Audit Committee must be comprised solely of Directors of Smartshares and Independent Directors of NZX.
5. The Audit Committee must be comprised of a majority of Directors who are either Independent Directors of Smartshares or Independent Directors of NZX.
6. Any Independent Director of NZX that sits on an Audit Committee must provide the Special Division with written certification that they accept the obligations and responsibilities of being a member of that Audit Committee imposed by the Rules in relation to the Fund.
7. At least one Smartshares Director must sit on the Audit Committee.
8. The Director(s) of Smartshares who sits on the Audit Committee must report the findings of that Committee back to the Smartshares Board.
9. The Directors of Smartshares must respond to any recommendations made to the Smartshares Board by the Audit Committee.
10. The Audit Committee has full powers to require Smartshares to provide any information relating to the Fund needed to enable it to meet the obligations of an Audit Committee.

### **Issue of baskets of Units**

11. The waiver from Rule 7.3 only applies to the issue of baskets of units in the Trusts undertaken in accordance with the provisions of the Trust and terms of the Trust Deeds.

### **Disposal or acquisition of assets**

12. The waiver from Rule 9.1.1 only applies to the transfer of the bare legal title of Trust Securities through the CSS.

### **Material Transactions with Related Party**

13. The waiver from Rule 9.2.1 only applies to:
  - a. the withdrawal of baskets undertaken in accordance with the provisions of the Trust and terms of the Trust Deeds;
  - b. the payment of Smartshares' management fee in accordance with the provisions of the Trust and terms of the Trust Deeds; and
  - c. on-market transactions of Trust securities through the CSS.
14. Smartshares must notify the Special Division in writing:
  - a. no less than 10 business days before any material change occurs to the CSS Rules as they relate to securities lending or to any of the arrangements for the lending of Trust Securities through the CSS; and

- b. of any matter material to the lending of Trust Securities through the CSS as soon as reasonably practicable after Smartshares becomes aware of the same.

**Information provided to unitholders**

- 15. Smartshares must provide unitholders in each of the Trusts with, as a minimum weekly, the following information:
  - a. the extent to which each Trust has tracked the index in its portfolio composition (and if not, by how much);
  - b. the amount of income of each Trust, which would otherwise be distributed, that has been capitalised to correct tracking discrepancies; and
  - c. the current net asset value of each Trust.
- 16. Smartshares must include the following information in its half-year report:
  - a. the extent to which each Trust has tracked its intended index in its portfolio composition (and if not, by how much);
  - b. the level of income, which would otherwise be distributed, which has been capitalised to correct tracking discrepancies;
  - c. the current net asset value of each Trust;
  - d. a statement of financial performance;
  - e. a statement of cash flows;
  - f. statements of movement in unitholder funds;
  - g. a statement of financial position;
  - h. a statement of accounting policies adopted in the reporting period; and
  - i. any major changes in value of assets, as per Listing Rule 10.3.2.