

**INTRODUCTION OF COMPOSITION SYSTEM AND MANDATORY MINIMUM
PENALTIES BY DISCIPLINARY COMMITTEES
FOR RULE VIOLATIONS IN THE DERIVATIVES MARKET**

19 DECEMBER 2007

A. INTRODUCTION

1. Enhancements to SGX enforcement framework

1.1 The Singapore Exchange Limited (“SGX”) is proposing to introduce two proposals to enhance its enforcement framework for rule violations in the derivatives market, namely:

- (a) a composition system; and
- (b) mandatory minimum penalties to be imposed by the Disciplinary Committees for a limited number of rule violations of greater severity.

1.2 SGX intends to introduce these proposals to the securities market in due course, and will seek comments from the public in a subsequent consultation.

B. BACKGROUND

2 Current Framework

2.1 Under the current enforcement framework, when investigations by SGX reveal that an offender has violated any rule in the SGX Rulebooks, SGX may carry out the following enforcement action(s), namely:


- (a) issuing a letter of warning to the offender; or
- (b) commencing Disciplinary Committee proceedings against the offender.

3 Proposed Composition System

3.1 SGX proposes to introduce a composition system, which provides an alternative option of allowing an offender to resolve a rule violation by fulfilling certain conditions without going through the process of Disciplinary Committee hearings. A typical condition of composition will involve the payment of a stipulated composition sum to SGX.

3.2 The composition system will offer a useful additional enforcement tool to address cases which are administrative in nature or of moderate severity. This system will promote more efficient disposal of cases which are administrative or strict liability in nature (for example, failure to submit names of Inter Dealer Broker for over-the-counter transactions by Members under DC Clearing Rule 7.02A.2.5).

3.3 At the same time, for rule violations of moderate severity, a composition system would serve the useful function of a middle ground option between the issuance of a letter of warning and bringing the offender before a Disciplinary Committee. The table below illustrates the proposed enforcement framework.

No.	Enforcement Action	Adjudicatory Body	Increasing severity of sanction
1	Warning letter	SGX	
2	Proposed composition system	SGX	
3	Sanctions under Futures Trading Rule 7.6.2 and DC Clearing Rule 4.03A.4. These include expulsion, suspension, penalty, reprimand, education/compliance programs etc	Disciplinary Committee	

3.4 The proposed composition system facilitates prompt resolution of cases as SGX may offer the option of composition to the offender upon conclusion of its investigations. Upon payment of the composition sum and fulfillment of any other condition(s) which may be imposed by SGX, the matter is concluded without the need to commence any disciplinary hearings before the Disciplinary Committee.

3.5 If an offender does not accept the offer of composition, SGX retains the discretion to refer the matter to the relevant Disciplinary Committee for adjudication. In this way, due process will always be available to the offender. Varying forms of such a composition system have been adopted by many major exchanges.

C. PROPOSED STRUCTURE OF THE COMPOSITION SYSTEM

4. An offer of composition is a voluntary offer by SGX to the party in violation of a rule to pay a fixed sum to SGX and fulfill any accompanying terms to settle the matter. Payment of the fixed sum and fulfillment of the terms has the effect of a full and final settlement of the matter. No further proceedings shall be taken against the offender for the same rule violation.

5. *Duration of composition offer.* Once composition is offered, SGX will not commence Disciplinary Committee proceedings until the offer of composition lapses after a pre-determined period from the date of the offer. SGX intends to allow the composition offer to be available to the offender for a period of fourteen (14) days. SGX retains the discretion to extend this period if there are good reasons to do so.

6. *Classification of rule violations.* The rule violations under the Futures Trading Rules and DC Clearing Rules have been classified into two categories, namely “compoundable” or “non-compoundable” violations. Violations which are classified as “compoundable” are violations for which SGX has the option to offer composition and stipulate any accompanying terms in order to settle the matter.

7. SGX will consider all relevant factors in deciding whether to offer composition to the offender. Such factors may include, but are not limited to:

- (i) the severity and magnitude of the rule violation;
- (ii) the culpability of the offender;
- (iii) the impact on the market and market participants; and
- (iv) the offender’s previous rule violations, including whether and how many times composition has been offered previously, if any.

8. In all cases where the rule violation is classified as “compoundable”, the decision by SGX to offer composition and the terms of the composition offer is in its sole discretion. SGX retains the discretion to refer a rule violation to the Disciplinary Committee without an offer of composition even if the rule violation has been classified as compoundable. See proposed Futures Trading Rule 7.2.1A (e) and DC Clearing Rule 4.02AA (e).
9. *Range of composition sums.* The proposed range of composition sums lies between S\$250 to S\$8,000 for Approved Traders and Registered Representatives and between S\$500 to S\$10,000 for Members, depending on whether it is a first or subsequent rule violation.
10. *Publication of schedules in Rulebooks.* To promote greater transparency of SGX’s enforcement actions, SGX proposes to publish schedules in the respective rulebooks setting out guidelines on the range of composition sums it may offer. The proposed schedules for compoundable rule violations under the Futures Trading Rules and DC Clearing Rules are set out in **Appendices A and B** respectively.
11. If an offer of composition is made to a repeat offender, the composition fine will be offered at a higher tariff. SGX will consider records for a period of up to three years preceding the date of the commission of the current rule violation(s) for the purposes of determining repeat rule violations.
12. SGX retains the discretion to offer composition to a Member, Approved Trader or Registered Representative of an amount which exceeds these guidelines. However, the amount of composition that SGX may offer for each rule violation shall not exceed S\$10,000. See proposed Futures Trading Rule 7.2.1A (d) and DC Clearing Rule 4.02AA (d).
13. For the purposes of determining the composition sum, violations will be classified as a first or subsequent rule violation only in respect of the same rule violation in the rulebooks. For example, if one commits a violation of Futures Trading Rule 3.3.18 for failure to submit a report on open positions, a previous violation under Futures Trading Rule 3.2.6 for non-settlement of margins due will not constitute a previous rule violation for the purposes of determining the tariff for an offer of composition. The transgressor will still be treated as a first offender for the purpose of determining the composition sum in relation to the rule violation under Rule 3.3.18.
14. Acceptance of a composition offer by SGX amounts to an admission of liability by the offender and will be deemed a conviction of the rule violation. See proposed Futures Trading Rule 7.2.1A (h) and DC Clearing Rule 4.02AA (h).
15. If the offender does not accept the offer of composition within the stipulated period, SGX may commence disciplinary proceedings against the offender.

D. MANDATORY MINIMUM PENALTIES TO BE IMPOSED BY DISCIPLINARY COMMITTEES FOR SPECIFIED RULE VIOLATIONS

16. *Non-compoundable violations.* For serious violations which have been categorised as “not compoundable”, SGX will continue to adopt the current approach of bringing such cases before the Disciplinary Committee for disciplinary action against the offender. While SGX’s existing rules provide for maximum penalty sums of \$250,000, no minimum penalty is stipulated.
17. As a complementary measure to the proposed composition system, SGX also proposes to introduce mandatory minimum penalties which Disciplinary Committees must impose for non-compoundable violations if it is satisfied that the charges brought before them have been established.

18. Mandatory minimum penalties also serve to ensure that the quantum of any penalty imposed by the Disciplinary Committee for all non-compoundable violations does not fall below the upper end of the range of composition sums. This underscores that these violations are viewed seriously by SGX. Mandatory minimum sentences will also assist to ensure an overall consistency in the sentencing approach within the sentencing framework.
19. SGX proposes two categories of mandatory minimum penalties for non-compoundable violations – specific minimum penalties and general minimum penalties.
20. *Specific minimum penalties.* Such penalties are designated for particularly egregious rule violations which mirror the provisions of Part XII of the Securities and Futures Act (for example, market manipulation under Futures Trading Rule 3.4.1). Higher minimum penalties have been proposed to reflect the severity of these rule violations.
21. *General minimum penalties.* All other non-compoundable rule violations will be prescribed general minimum penalties. The proposed general minimum penalty is S\$10,000.
22. Please refer to **Appendices A and B** for the proposed mandatory minimum penalties for non-compoundable violations under the Futures Trading Rules and the DC Clearing Rules respectively.
23. Where a minimum penalty sum has been stipulated in respect of a particular rule violation, if the Disciplinary Committee is satisfied that the Exchange has established the charge, the Disciplinary Committee must impose a penalty not lower than the stipulated minimum amount. In addition, the Disciplinary Committee may choose to impose, in addition to the minimum penalty, any one or more of the sanction(s) as set out in Futures Trading Rule 7.6.2 or DC Clearing Rule 4.03A.4. See proposed Futures Trading Rule 7.6.2A (b) and DC Clearing Rule 4.03A.5 (b).
24. For the avoidance of doubt, where SGX exercises its discretion to refer cases which are classified as “compoundable” to the Disciplinary Committee, there are no mandatory minimum penalties which must be imposed upon establishment of the charge(s).

E. SEGREGATION OF COMPOSITION SUMS COLLECTED

25. In line with our current practice for penalties imposed by Disciplinary Committees, the monies collected from composition sums will be channeled to a segregated account, which will not go towards SGX’s revenues. The collected sums will be earmarked by SGX for use towards funding of educational initiatives for market participants.

F. REQUEST FOR COMMENTS

26. We seek your comments and welcome both substantive as well as drafting comments. In particular, we would like your views, if any, on the following issues:
 - (a) what are your views on the classification of rule violations into the categories of “compoundable” and “non-compoundable”? Are there any rule violations which should be more appropriately classified in another category? Please state the rule violation and the reason for your proposed classification.
 - (b) are the proposed ranges of composition sums for Members, Approved Traders and/or Registered Representatives for the various rule violations appropriate? If not, should they be higher or lower? Please give reasons.

- (c) besides pecuniary terms, what other terms of settlement would be appropriate when SGX makes offers of composition to offenders?
- (d) for the purposes of determining the composition sum for repeat offenders, should SGX consider records of rule violations committed more than 3 years preceding the current rule violation?
- (e) what are your views on the proposed mandatory minimum penalties to be imposed by Disciplinary Committee for specific rule violations in the Futures Trading Rules and the DC Clearing Rules? Is the proposed general minimum penalty of \$10,000 for non-compoundable violations appropriate? If not, should it be higher or lower? Please give reasons.
- (f) besides minimum penalties, are there any other sanctions under Futures Trading Rule 7.6.2 and DC Clearing Rule 4.03A.4 which should be mandatory if the Disciplinary Committee is satisfied that the charge has been established? For example, should minimum periods of suspension of the Member, Approved Trader or Registered Representative be a mandatory sanction for certain non-compoundable rule violations? Please state the rule violation and give reasons for your views.
- (g) SGX intends to introduce the composition system and mandatory minimum penalties proposals to the derivatives market before implementing these proposals in respect of rule violations in the securities market. Do you have any concerns with this approach?

G. PROCEDURE AND DEADLINE TO SUBMIT COMMENTS

27. Written submissions are to be sent to the Exchange through email *and* either by post/courier or by fax:

Email: rules@sgx.com

AND

Post/Courier: Singapore Exchange Limited
2 Shenton Way, SGX Centre 1
#27-00,
Singapore 068804

Attn: **Chng Hwee Chin, Regulatory Policy**
Fax: 6535 5573

28. Comments should be organized in the following manner:
- (a) cover page;
 - (b) statement of interest
 - (c) table of contents;
 - (d) summary of major points;
 - (e) comments; and
 - (f) conclusion.
29. Supporting material may be placed in an annex. All submissions should be clearly and concisely written, and should provide a reasoned explanation for any proposed revision to the rules. Where feasible, participants should identify the specific rule on which they are commenting. In any case in which a participant chooses to suggest revisions to the text of the rules, the participant should state clearly the specific changes to the text that they are proposing.
30. All submissions should be made on or before **9 January 2008**. Submissions must be submitted in both hard and soft copies (in Microsoft Word format) and font size should be no smaller than Times New Roman 11pt. Participants submitting comments should include their personal/company particulars as well as their correspondence address, contact numbers and email addresses on the cover page of their submissions.
31. The Exchange reserves the right to make public all or parts of any written submission and to disclose the identity of the source. Participants may request confidential treatment for any part of the submission that the participant believes to be proprietary, confidential or commercially sensitive. Any such information should be clearly marked and placed in a separate annex. If the Exchange grants confidential treatment, it will consider the comments but will not publicly disclose the information. If the Exchange rejects the request for confidential treatment, it will return the information to the party that submitted it and will not consider the information as part of its review. In the interests of market transparency, participants should limit any request for confidential treatment of information submitted. The Exchange will not accept any submission that requests confidential treatment of all, or a substantial part, of the submission.