

## Guidance Note

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### Key concepts:

Factors considered in determining what a significant breach is

Factors considered in determining a penalty or sanction

### Related information:

FGL Operating Rules

Part 3, Part 4, Part 7 and Part 8

FEX Guidance Notes

GN 9 - Monitoring and Enforcing Compliance

ASIC Regulatory Guides

RG 78 – Breach Reporting by AFS Licensees

### Recommended Audience:

Trading Participants

Clearing Entities

Derivatives Staff Members

### Previous Issues:

Nil

## GN 6 – What is a Significant Breach?

### Introduction

In considering whether a breach or an alleged or suspected breach is a “significant breach” or not, the Exchange will assess, on a case by case basis, the circumstances surrounding the breach or alleged or suspected breach.

In considering what penalty or sanction (if any) to impose, the Exchange will consider the factors set out in this Guidance Note.

### Guidance

In drafting the Operating Rules, FGL has, as far as practicable, taken guidance from and followed the Corporations Act requirements.

In this regard, identifying a “significant breach” for the purposes of disciplinary proceedings is similar to the approach adopted by section 912D(1)(b) of the Corporations Act which uses the term “significant breach”. The term “significant breach” is not a defined term in the Corporations Act. However, ASIC has provided its interpretation and examples of what may constitute a “significant breach” in an ASIC Guide (entitled “Breach reporting by AFS licensees”). The Exchange has had regard to ASIC Regulatory Guide 78 in preparing this Guidance Note.

An approach which definitively treats any one breach of a particular Rule as “significant” can lead to inappropriate or inequitable results. For example, in one particular instance a breach may be determined as not a significant breach as it was an isolated instance, and yet in another instance a single breach of the same specific Rule may be determined as a significant breach as it represented a systemic failure

For this reason, the Exchange does not intend to provide a list of specific Operating Rules that will constitute a “significant breach” as each breach will be assessed on a case by case basis and the individual circumstances surrounding the breach will be considered (together with any other mitigating or aggravating factors described below).

However, in an attempt to provide a level of clarity and certainty to Trading Participants, Clearing Entities and their Derivatives Staff Members (and users of the Exchange Market in general), this Guidance Note provides:

- 1 Factors which will be considered in assessing whether a breach is significant;
- 2 Factors which will be considered in determining what penalty or sanction (if any) to impose; and
- 3 Examples of the types of conduct which may constitute a significant breach.

## 1. Factors which will be considered in assessing whether a Breach is significant

In considering whether a breach or an alleged or suspected breach is a significant breach or not, the Exchange will assess, on a case by case basis, the circumstances surrounding the breach or an alleged or suspected breach such as:

- How the breach arose;
- The Operating Rules allegedly breached;
- Any mitigating and aggravating factors e.g. whether the breach was inadvertent or deliberate (refer to point 2 below);
- Whether any parties incurred actual or potential financial loss;
- The impact of the breach on the ability of the Trading Participant or Clearing Entity to provide Financial Services or to operate its Derivatives business;
- The impact of the breach on the reputation of the Exchange
- The extent to which the breach indicates that the Trading Participant or Clearing Entity has (or had) inadequate compliance and supervisory arrangements;
- Whether the breach is a repeat offence. The greater the number and frequency of breaches of a similar nature, the more likely it is that the Exchange will consider it to be significant; and
- Any other circumstance deemed to be relevant at the time.

These factors are based loosely on those set out in section 912D(1)(b) of the Corporations Act.

The Exchange considers that where a Trading Participant or Clearing Entity identifies a breach or an alleged or suspected breach as part of its ongoing compliance and supervisory arrangements, it should also take into consideration the above circumstances surrounding the breach (together with any other mitigating or aggravating factors set out in point 2 below) and make a determination as to whether the breach is significant. Where it is determined by a Trading Participant or Clearing Entity to be significant, then the Trading Participant or Clearing Entity is obliged, pursuant to Operating Rule 3.8.4, to notify the Exchange within the time specified in the Rules Procedures (within 5 Business Days).

A Trading Participant or Clearing Entity will need to make its own decision as to whether a breach or an alleged or suspected breach is significant and thus, subject to notification to the Exchange (and, where the Trading Participant or Clearing Entity is the holder of an AFS Licence, reportable to ASIC). Where a Trading Participant or Clearing Entity is in doubt as to whether a breach or an alleged or suspected breach is significant, the Exchange encourages Trading Participants and Clearing Entities to notify the matter to the Exchange.

## 2. Factors which will be considered in determining what penalty or sanction (if any) to impose

The aim of this section of the Guidance Note is to set out the general principles and factors that will be taken into account by the Compliance and Conduct Committee (“CCC”) when determining what penalty or sanction (if any) to impose following the conduct of disciplinary proceedings under Part 7 of the Operating Rules. These factors are not an exhaustive list of the principles and factors which may be taken into account and other factors may be considered depending on the circumstances of the individual matter.

When considering how to sanction a Trading Participant, Clearing Entity or Derivatives Staff Member for a breach of the Operating Rules, the CCC will:

- Consider the principles set out in this Guidance Note;
- Consider all of the relevant circumstances surrounding the breach; and
- Exercise its sanctioning power judiciously, fairly and impartially.

When determining the relevant or appropriate sanction, the CCC will, in particular, consider:

- The nature and relative seriousness of the breach; and
- Whether there are any mitigating or aggravating factors.

Sanctions should not only be remedial in nature, but also serve as a deterrent to all Trading Participants, Clearing Entities and their Derivatives Staff Members in relation to future misconduct or breaches of the Operating Rules. They should be imposed to protect investors and the reputation and integrity of the Exchange. Justice should be seen to be done. If Trading Participants, Clearing Entities and their Derivatives.

Staff Members are satisfied that justice has been done and that the Operating Rules are properly and fairly enforced, then they will continue to have confidence in their dealings on the Exchange.

In determining what sanctions to impose, the CCC will take into account the principles of natural justice including (but not limited to) that the sanction:

- Must be tailored and suitable to the misconduct in question. This means that the sanction needs to be fair, neither too lenient nor too onerous, given the nature, severity and frequency of the breach or misconduct;
- May not be imposed retrospectively where the breach arises as a result of a change to the Operating Rules that had not been notified to Trading Participants, Clearing Entities and their Derivatives Staff Members at the time of the breach;
- Must not give more favourable or preferential treatment to any Trading Participant, Clearing Entity or Derivatives Staff Member than would be given to any other Trading Participant, Clearing Entity or Derivatives Staff Member (for example by virtue of their identity or commercial relationships);
- Must take into account sanctions previously imposed by the CCC and/or Appeals Tribunals for similar breaches or in similar circumstances; and
- Must take into account relevant considerations and ignore those that are irrelevant.

The CCC will also weigh the likely effectiveness of imposing the sanction (as a remedial and/or deterrent measure) against the likely effect of the sanction on the particular Trading Participant, Clearing Entity and/or Derivatives Staff Member.

### **Examples of mitigating or aggravating factors**

The CCC will take the following mitigating or aggravating factors into account when deciding upon the relevant or appropriate sanction for a breach of the Operating Rules before it:

- Whether it was a first time breach by the Respondent or whether it has a history of misconduct or breaches;
- Whether the breach or misconduct was a one-off occurrence or was repeated by the Respondent over a period of time;
- Whether the breach or misconduct was unintentional, inadvertent, negligent, deliberate or fraudulent;
- Whether the Respondent reported the breach itself or attempted to conceal the breach;
- Whether the Respondent co-operated with the investigation/disciplinary proceedings, and in particular whether it decided at an early stage not to contest the proceedings;
- Whether the Respondent made any personal financial gain or advantage as a result of the breach or misconduct, and if so the size of that gain or advantage;
- Whether any other person suffered, or could have suffered, loss as a result of the breach or misconduct, and if so the size of that loss and whether the Respondent has taken any steps to redress the loss;

- If the Respondent is an individual, whether his/her employer had in place suitable compliance and supervisory arrangements, operational or technical procedures and controls, and whether the breach was symptomatic of a corporate culture of non-compliance with the Operating Rules;
- Whether the Respondent has taken any steps to prevent future breaches of a similar nature;
- Whether the Respondent placed reasonable reliance on independent professional accounting or legal advice; and
- Whether the breach or misconduct damaged, or could have damaged, the reputation and integrity of the Exchange.

### 3. Examples of types of conduct which may constitute a Significant Breach

Examples provided in this section of the Guidance Note are for illustrative purposes only. *They are not exhaustive.* As described above, in considering whether a breach or an alleged or suspected breach is a significant breach or not, the Exchange will assess, on a case by case basis, the circumstances surrounding the breach.

Following are some examples of the types of conduct which may constitute a significant breach:

Failing to comply with the conditions of an AFS Licence or an Offshore Licence (where applicable) such as acting outside the scope of the Trading Participant's or Clearing Entity's authorisations;

- Failing to comply with the terms or conditions of any exemption or relief from the requirement to hold an AFS Licence or an Offshore Licence (where applicable);
- Where the breach is a repeat offence. The greater the number of breaches of a similar nature, the more likely it is that the Exchange will consider it to be significant. This is on the basis that the issue may be systemic or indicate that the Trading Participant or Clearing Entity does not have adequate compliance or supervisory arrangements in place to identify deficiencies in internal procedures;
- A breach of the Capital Level requirements under Operating Rule 3.4. If the minimum requirements are not met, the Trading Participant or Clearing Entity may not have the financial ability or capacity to provide Financial Services or operate its Derivatives business;
- Where the breach resulted, or may result, in any party incurring actual or potential financial loss. Any such breach impacting on a Client is more likely to be significant than if the financial loss only impacted the Trading Participant or Clearing Entity itself. However, where the breach is an isolated instance or technical in nature and the amount of the loss to the Client or Clients involved is small, the breach may not necessarily be considered to be significant.
- Where a financial loss was incurred following a breach which only impacted the Trading Participant or Clearing Entity itself it is less likely to be considered to be significant. However, if the amount of the financial loss suffered by the Trading Participant or Clearing Entity was substantial, this could influence the decision as to whether the breach was significant as a substantial or material loss could affect the ongoing compliance with the minimum Capital Level requirement;
- Where the breach involves a substantial failure to comply with any reporting obligations and in particular, the reporting obligation under:
  - Operating Rule 3.4.1 - periodic report of financial position
  - Operating Rule 6.3.5 – open interest reports (in the case of a Clearing Entity)
  - Operating Rule 3.4.2 - Beneficial Owner reports
  - Operating Rule 3.8.3 - notification of change in Licence or exemption or relief where that change in material
  - Operating Rule 3.8.4 – notification of breaches and investigations
  - Operating Rule 3.8.5 - notification of Unprofessional Conduct
  - Operating Rule 3.8.6 - notification of breach, suspension or cancellation of Licence
  - Operating Rule 3.8.7 - notification of default

- Operating Rule 3.8.8 - notification relating to clearance and settlement
- Operating Rule 3.8.9 - notification of Insolvency
- Operating Rule 3.8.10 - notification of errors and mistakes
- Operating Rule 3.8.11 - notification of Derivatives Staff Member offences
- Operating Rule 3.8.12 - notification of disappearance and termination for cause of Derivative Staff Member
- Operating Rule 3.8.13 - notification of damage or interruption to systems
- Where the breach has or may cause disruption to the Trading System and in particular, where the breach relates to:
  - Operating Rule 3.7.3 - protection of the Trading System
  - Operating Rule 4.2.5 – use of the Trading System
  - Operating Rule 4.2.8 – Order Router Facility
- Where the breach compromises or may compromise the security procedures for any FGL Product Market or the Trading System and in particular, where the breach relates to;
  - Operating Rule 4.2.13 - review of security measures
- Where the breach has or may compromise the fair, orderly and transparent conduct of the Exchange Market or any FGL Product Market and in particular, where the breach relates to;
  - Operating Rule 3.3.1 – general duties of honesty and fairness
  - Operating Rule 3.7.2 – password
  - Operating Rules 3.7.4 to 3.7.6 – various in relation to supporting records with respect to Orders and Trades
  - Operating Rule 4.2.7 - entry of Orders into the Trading System
  - Operating Rule 4.2.9 - price limits
  - Operating Rule 4.2.10 - position limits
  - Operating Rule 4.3 – trading prohibitions
  - Operating Rule 4.4 – strategy trading
  - Operating Rule 4.5 - block trades
  - Operating Rule 4.6 – EFPs
  - Operating Rule 4.10 – Pre-Negotiated Orders
- Where the breach has or may compromise the integrity or reputation of the Exchange and in particular, where the breach relates to:
  - Operating Rule 2.3.7 - monitoring and enforcement arrangements
  - Operating Rule 3.3.6 - false, misleading or deceptive information
  - Operating Rule 3.3.11 - risk management procedures
  - Operating Rule 3.5 – obligations regarding records
- Where the breach has or may compromise the protection of Trading Participants or Clearing Entities against the risk and consequences of default and in particular, where the breach relates to:
  - Operating Rule 3.6.2 – Client Agreement
- Where the breach in the opinion of the Exchange, constitutes or evidences a material or substantial failure by the Trading Participant or Clearing Entity to comply with the Operating Rules, or to have systems in place to ensure that the Trading Participant or Clearing Entity complies with the Operating Rules and can monitor its ability to comply.

The Appeals Tribunal will consider the factors outlined in this Guidance Note in conducting an appeal under Part 8 of the Operating Rules.

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