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## Regulation of a Demutualized Exchange (Singapore)

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### 9.1 Background

In 1997, the Singapore Government formed a Financial Sector Review Group, initiating a comprehensive study of the strategies and approaches towards regulating and developing the financial sector in Singapore. One major focus of the review was to develop strategies to broaden and deepen Singapore's capital markets. Two private sector committees were set up—a Corporate Finance Committee and a Stock Exchange of Singapore (SES) Review Committee, both chaired by private sector professionals. The government subsequently accepted the recommendations of the SES Review Committee to liberalize stockbroking commissions, and progressively open access to the exchanges.

The SES Review Committee also highlighted the need to fundamentally review the governance structure of the Stock Exchange of Singapore before opening up access. A third committee was therefore set up, the Committee on the Governance of the Exchanges (CGE), to follow up on this basic issue for both exchanges in Singapore, the SES and Singapore International Monetary Exchange (SIMEX). The CGE included Monetary Authority of Singapore (MAS) officers, SES and SIMEX members, the Presidents of the two exchanges, capital market participants and corporate lawyers. Among other things, the CGE recommended that SES and SIMEX be demutualized and merged into a single integrated privately-held stock company. The demutualization and merger was effected pursuant to a statute passed for that purpose, *The Exchanges*

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*(Demutualization and Merger) Act*. The process was completed in 1999 with the launch of the Singapore Exchange (SGX), and was followed by SGX's listing on its own mainboard in 2000.

## **9.2 Regulatory Issues Arising from Demutualization**

### **9.2.1 Changes due to Ownership**

The key regulatory issue arising from the demutualization of SGX is whether the changes to its ownership and operating structure will undermine its ability to discharge its role as a frontline regulator competently and effectively. It should be noted, however, that conflicts of interests issues are not new to demutualized exchanges. Prior to their demutualization and merger, SES and SIMEX already assumed regulatory and business development functions concurrently with potential conflicts on two levels:

- (i) members of the exchanges had to set and enforce rules in the public interest that could negatively affect their commercial interests.
- (ii) the exchanges were also expected to conduct effective and impartial supervision of their own members.

The potential conflicts of interests in these respects were mitigated by the fact that in a mutually-owned exchange, members share the financial and reputation risks from a failure to properly regulate.

### **9.2.2 Potential Conflicts**

With the demutualization and listing of SGX, a new set of potential conflicts arises. While profits were never irrelevant to the mutual exchanges, it has become the primary motive for shareholders of the listed SGX. Share values and dividends reflect more transparently earnings and prospects, providing the management with greater incentive to raise operational efficiency, and seek competitive advantage. This is as it should be, and is indeed a principle benefit of demutualizing and listing SGX. There will however be concern from time to time as to whether the greater drive for commercial success will reduce the commitment and resources

deployed by the exchange to effectively fulfill its regulatory and public interest responsibilities at an appropriate standard.

### **9.2.3 The “Public Interest”**

On the other hand, the interest of SGX shareholders and the “public interest” as represented by the users of the exchange can be presented as for the most part aligned rather than divergent. Common interest in a well-run liquid and large market place is not altered by the demutualization of SGX. A fair, transparent and efficiently-regulated market is indispensable to the vibrancy and sustained business success of SGX. Serious investors will not trade on an exchange that does not have internationally acceptable rules of listing, trading and settlement, or does not enforce the rules fairly and effectively. Without the interest and liquidity provided by investors, no exchange will find it easy to attract issuers and to build its business.

### **9.2.4 Credibility**

Credibility in regulation is therefore a vital commercial asset for SGX. Strong, effective and fair supervision is key to SGX’s brand name. Corporate governance of SGX is not designed to favour short-term revenue objectives at the expense of long-term gains. Shareholders would also have it in their interests to hold the exchange to high standards of market regulation, so as to achieve sustained returns on their investments.

## **9.3 The Regulatory Relationship between the Monetary Authority of Singapore and Stock Exchange of Singapore**

### **9.3.1 The Monetary Authority of Singapore’s Role**

A demutualized, listed exchange however requires an enhanced role for the MAS in some respects, even as the functions of SGX and MAS are more clearly delineated than in the past. *The Exchanges (Demutualization and Merger) Act* passed in 1999 was drafted to give MAS the power to issue directives to SGX in the interest of ensuring fair and orderly securities and futures markets, and the proper management of systemic risks. MAS has the authority to put things right, where any potential conflicts of interest become real.

### 9.3.2 The Stock Exchange of Singapore's Responsibilities

The SGX retains direct and frontline regulatory responsibilities of the securities and futures markets, and over the broker-dealers who trade on the exchange. MAS, as the statutory regulator, administers the corpus of statutory law regulating the capital markets, as well as maintains oversight of SGX's exercise of its regulatory responsibilities, and seeks to ensure that there are no gaps in the overall regulatory framework.

### 9.3.3 Areas of Regulation

Details of MAS' regulatory relationship with SGX in the major areas of regulation are as follows:

- *Appointment of Senior Management.* Under a notification issued pursuant to the Exchanges (Demutualization and Merger) Act, SGX was required to establish a nominating committee comprising not less than four members of SGX's board of directors. All appointments to the nominating committee are subject to MAS' approval. The nominating committee is responsible for reviewing all nominations for appointment or re-appointment of members of SGX's board of directors and the chief executive officer of SGX. The nominating committee shall take into consideration, *inter alia*, that nominated candidates are fit and proper persons to hold such office, taking into account the candidates' track record, age, experience, capabilities and other relevant factors. MAS' prior approval is required for the appointment of the Chairman of SGX's board of directors and the chief executive officer.
- *Supervision of Listings.* SGX defines and enforces the rules that apply to companies seeking to raise capital on the exchange through primary or secondary issues. MAS' approval must be sought for any changes to SGX's listing rules. SGX enforces the continuous listing requirements on companies, to see to it that listed companies maintain timely and adequate disclosure of material information. SGX has the power to suspend and de-list an issuer if a company fails to meet the standards set out in the listing rules. Continuous disclosure by listed companies will also become a statutory obligation

under the proposed Securities and Futures Act (SFA).<sup>2</sup> This means that non-disclosure or late disclosure of material information by listed companies will be a breach of the law, not just a breach of SGX's listing requirements, and carry either civil or criminal penalty.

- *Market Surveillance.* SGX carries out market surveillance to detect unusual trading activities that could reflect attempts to manipulate the market. Such surveillance efforts could also lead to discovery of parties trading on privileged insider information. SGX has the power to suspend or de-list an issuer if conditions for orderly trading are found to be absent. MAS will carry out independent surveillance on a selective basis, to ensure that SGX is performing its responsibilities effectively. MAS will have the power under the proposed SFA to pursue civil prosecution of listed companies which fail to make timely disclosure of material information, and of any participants suspected of market misconduct. The civil remedy regime for insider trading will be extended to cover other forms of market misconduct such as market manipulation, or the employment of fraud and deceit in dealing. Civil remedy, which lowers the burden of proof against offenders, will complement the present framework of criminal remedy for offences under securities law.
- *Supervision of Brokers.* SGX supervises and inspects brokers to ensure that they comply with SGX's rules, are prudentially sound, and uphold high standards of market integrity. SGX has to act swiftly and firmly to deal with any unprofessional conduct by brokers and their representatives. MAS conducts continuous off-site review of brokers' operations to check if they comply with statutory licensing requirements. Such off-site reviews are complemented by MAS' selective, on-site inspection of brokers to assure itself of the competence and effectiveness of SGX's supervision.
- *Regulation of SGX as a Self-Listed Entity.* When the SGX was listed on its own mainboard, MAS assumed the role of frontline regulator for the listing and trading of SGX's shares. MAS was the approving authority for SGX's listing, and was directly responsible for vetting SGX's prospectus. MAS is the supervisory authority for SGX's compliance with its own listing rules. MAS also conducts surveillance

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<sup>2</sup> The Securities and Futures Bill is an omnibus legislation which will consolidate the provisions within *the Securities Industry Act and the Futures Trading Act*, as well as introduce some structural policy reforms in the regulation of the capital markets.

of trading in SGX's shares, and monitors the continuous disclosure of material information by SGX. MAS has powers under *The Exchanges (Demutualization and Merger) Act* to issue directives to SGX to resolve any conflicts of interest arising from its self-listing. Such conflicts are also addressed in a Deed of Undertaking to the MAS. Pursuant to the Deed, SGX has appointed a Conflicts Committee to deal with such issues, and MAS is the approving authority for the composition of the Committee.

- *Approval of Substantial Shareholdings in the SGX.* Under the *Exchanges (Demutualization and Merger) Act*, anyone who wishes to acquire 5% or more of SGX is required to seek prior approval from MAS. This provision recognizes the unique and important role of SGX in providing the infrastructure and marketplace for the trading, clearing and settlement of securities and derivatives in Singapore.

In reviewing applications from investors to acquire more than a 5% stake in SGX, MAS has made the following announcement:

- MAS will allow suitable strategic investors who can promote SGX's growth and development to acquire substantial stakes of 5% or more in SGX. The size of their permitted stakes will depend on what these strategic investors can contribute to the exchange in terms of business alliances, technology or other ways of supporting the business and infrastructure of the exchange.
- MAS will also generally allow fund managers who invest pools of customer funds to hold SGX's shares beyond the 5% limit. The combined holdings of such a fund manager will be capped at 10%. This takes into account feedback from fund managers that they would like to hold larger absolute stakes in SGX than the 5% limit allows. As key institutional players on the buy-side of the capital markets, the presence of fund managers would ensure a broader shareholder base for the SGX add to the diverse range of groups with an interest in the exchange.

## 9.4 Conclusion

Internationally, the regulatory relationship between the statutory regulator and exchanges is continuously evolving. There is no single model that is appropriate for all countries. In Singapore, with the demutualization and listing of SGX, the division of regulatory responsibilities between MAS and SGX has been explicitly defined. MAS believes that the current arrangements for the regulation and supervision of the securities and futures markets between MAS and SGX, with an enhanced oversight responsibility for MAS and powers to pursue civil prosecution, will prove robust. However, given the rapid changes in the capital markets brought about by globalization and technological advances, the arrangement can be expected to evolve over time. MAS' regulatory relationship with SGX will continually be reviewed, and recalibrated if necessary, in keeping with market developments, to ensure effective oversight of the capital markets in Singapore.