DIRECTIVE ~~FOR~~ ON COMPLIANCE ~~OFFICERS~~FUNCTION	**No. 3.36-001**

Relevant to	:	Rules 3.36 and 5.05
Introduced with effect from	:	15 August 2019
Amended	:	~~N/A~~ 30 November 2021 vide TP Circular No. 17/2021
TPs' Circular No(s).	:	6/ 2012
Refer also to Directive No(s).	:	N/A

1. Introduction~~Rule 3.36(b)~~

(1) **Rule 3.36(b)** provides that throughout a Compliance Officer's registration, the Compliance Officer must supervise and carry out proper checks and reviews to monitor and ensure the overall compliance by the Trading Participant and the Trading Participant's Registered Persons, employees and agents with the Securities Laws, these Rules and the Directives.

(2) **Rule 5.05** states that a Trading Participant must establish and maintain a compliance function which is responsible to monitor compliance with these Rules, Directives and the Securities Laws and to provide advice on all the relevant requirements that a Trading Participant must comply with, in carrying out the Trading Participant's business.

~~(2)~~(3) In discharging the obligations under the said Rules, a Compliance Officer and Trading Participant must, amongst others, comply with the requirements set out below.

1.1 Guidelines for Compliance Function for Trading Participants

(1) All Compliance Officers and Trading Participants must comply with the Guidelines for Compliance Function~~s~~ for Trading Participants ("**Compliance Guidelines**").

(2) The Compliance Guidelines are formulated to cater for all possible business and operational activities of a Trading Participant. A Compliance Officer and Trading Participant must apply and comply with the requirements that are relevant to its business and operational activities. A Compliance Officer and Trading Participant may omit to report those requirements which the Trading Participant deems as inapplicable if it does not undertake the stated business and operational activities. For example, a Trading Participant which is not carrying out discretionary trading need not comply with obligations on discretionary trading.

(3) The Compliance Guidelines are set out in **Appendix 1** of this Directive.

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APPENDIX 1

GUIDELINES FOR COMPLIANCE FUNCTION~~S~~ FOR TRADING PARTICIPANTS ("COMPLIANCE GUIDELINES")

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~~**1. PREFACE**~~

~~The compliance function in the derivatives industry is of critical importance in the context of the rapid change and growth taking place in the financial services sector. Increasing competition, pressure to operate profitably and to improve performance, introduction of new derivative products and rapid advancements in information processing and dissemination technology may result in risk management by Trading Participants lagging behind in their emphasis on sound operational controls. The most important message that this document intends to convey is that compliance should be looked upon as an entire system of –~~

~~(a) complying with laws, rules and guidelines issued by the relevant authorities under the regulatory framework;~~

~~(b) assuring a high quality of service to clients in order to maintain long-term profitable relationships with business partners;~~

~~(c) managing risk, particularly operational risk, as part of an enterprise-wide risk management framework that is aimed at providing greater certainty for cashflow management purposes, and hence enhancing risk-adjusted returns to shareholders of a broking firm; and~~

~~(d) encouraging one's peers to equally adopt a high standard in order to minimise credit, systemic and reputational risk in the interest of promoting long-term development of the industry.~~

~~Hence, this document is issued to address current compliance issues and to enhance compliance through guidance that will encourage self-regulation and sound risk management of derivatives. It is our expectation that senior management and compliance officers will play a more proactive and meaningful role in evaluating Trading Participants' internal controls system and cultivating a compliance culture in their organisation.~~

~~The compliance guidelines contained in this document are presented with the following functional objectives in mind:~~

~~a) to improve the quality and effectiveness of the compliance function;~~

~~b) to promote a compliance culture within, and self-regulation by the Trading Participants; and~~

~~c) to provide a uniform practice guide on compliance which would serve as a basis for guidance and measurement of performance of the compliance function by the compliance officer.~~

~~Senior management and compliance officers may find these guidelines useful in reassessing their supervisory, monitoring and compliance procedures. These Guidelines are organised into 4 major parts:~~

~~a) Part I encompasses an overview of the compliance function;~~

~~b) Part II covers compliance control and responsibilities. This part prescribes the requirement to establish a compliance culture within a Trading Participant and outlines the roles to be played by the board of directors and employees;~~

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~~c) Part III describes the role, duties and responsibilities of the compliance officer;~~

~~d) Part IV addresses the skills required by a compliance officer.~~

~~2. OVERVIEW OF THE COMPLIANCE FUNCTION~~

~~(1) To comply means compliance with all relevant laws, policies, procedures, guidelines, directives, rules and regulations. Compliance essentially refers to proper supervision and competent system of internal controls within a Trading Participant to maintain the integrity of its dealing practices, the safeguarding of its assets and compliance with all relevant regulatory requirements. Compliance is a component of proper business support and applies to all individual business activities and functions. Effective compliance requires the willingness of Trading Participants to police their own activities, eliminate bad practices and to maintain routine contact with the regulators.~~

~~(2) The biggest pitfalls of setting up a compliance function are:~~

~~a) the compliance function is seen as being solely the province of the compliance department. No one sees a specific compliance dimension to their job nor has one been expressly communicated to them;~~

~~b) personnel in the compliance department are inadequately trained and under-resourced;~~

~~c) the organisational objectives or corporate mission has failed to recognised the compliance function. The purpose of establishing a compliance department has not been communicated to the staff and the setting up of the compliance department is merely in response to the requirements of the Commission and the Exchange;~~

~~d) lack of acceptance by the board of directors and senior management of the role and importance of the compliance department/officer;~~

~~e) the compliance officer is often distracted by other duties and has not been designated with the appropriate seniority for the job;~~

~~f) failure to identify and manage conflict of interests;~~

~~g) failure to maintain professional independence; and~~

~~h) weak management supervision and control.~~

~~3. COMPLIANCE CONTROL AND RESPONSIBILITIES~~

~~(1) Compliance is a '*state of mind*' which needs to penetrate the whole fabric of the Trading Participant~~

~~in the way it is organised, managed and controlled. Each regulated business area of a Trading Participant e.g. dealing activities, customer documentation, payments and settlement activities, the handling of clients' funds, is responsible for complying with the relevant rules and laws and must maintain procedures that will ensure compliance.~~

~~(2) Each Trading Participant needs to adopt a *'compliance mission statement'* that will cultivate an environment, which encourages compliance. Problems arising from daily operations or key decisions and actions taken may impose a strategic or financial impact on the Trading Participant's compliance. In these cases, the compliance mission statement serves as a reference to ensure the Trading Participant remains compliant.~~

~~Roles and Responsibilities of the board of directors~~

~~The board of directors, besides approving all significant policies and procedures throughout the Trading Participant, should also ensure that:~~

~~a) a sound system of internal controls is maintained to safeguard shareholders' interests company's assets and clients' interests. This covers not only financial controls but operational and compliance controls, and risk management;~~

~~b) management effectively implements all policies and procedures set by the board of directors;~~

~~c) a fully-staffed compliance department is established and delegated with the responsibility of managing the Trading Participant's compliance with all relevant laws, rules, regulations, directives, guidelines, policies and procedures;~~

~~d) competent compliance personnel are available to review the effectiveness of organisational controls and procedures as well as verify the reliability of information reported;~~

~~e) proper procedures are in place to anticipate likely changes in the regulatory regime and compliance requirements that may be against the interest of the Trading Participant;~~

~~f) there are periodic discussions with management concerning the effectiveness of internal controls and risk management, and ensure the management has appropriately taken action on recommendations and concerns expressed by the compliance officer and auditors (regulatory auditors, internal and external auditors) with regards to internal control weaknesses and issues on non-compliance.~~

~~A strong and pro-active board of directors will foster an environment of strong internal controls and compliant procedures and practices~~

~~3.1 Establishment of compliance culture within the organisation~~

~~(1) To establish an effective compliance culture within the organisation, the organisation needs to:~~

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~~a) have a well-documented and up to date operations manual incorporating practices that ensure compliance. The operations manual should:~~

~~i. contain procedures that are practical and able to explain the rationale behind each requirement and the consequences if that requirement is not met; and~~

~~ii. clearly explain the individual responsibilities for each function to be performed.~~

~~b) have a proper system for record keeping. Complete and accessible records are vital in enabling the organisation to demonstrate it has complied effectively.~~

~~c) have effective channels of communication to ensure that all staff are fully aware of policies and procedures affecting their duties and responsibilities and any changes thereto.~~

~~d) provide induction training to new staff. Induction training should encompass explanation of the procedures relevant to the job and the corresponding compliance responsibilities.~~

~~e) assess staff for their competencies on a regular basis to identify training needs and promote personal development.~~

~~f) have a competent compliance officer to advise regulated business areas on key matters of compliance, to monitor that the business is complying in practice and to educate everyone in the organisation on how compliance is best achieved.~~

~~g) have a system of regular reporting. Regular reporting to board of directors is critical and should include both routine and exceptional matters. Compliance issues such as results of monitoring, changes in regulations, results of regulatory visits etc., should be compiled in a Compliance Report and be made a standing item to be discussed at the board of directors' meetings.~~

~~h) have an effective internal control system. When establishing an internal control system, management should include the following:~~

~~i. *Organisational structure*~~

~~This sets out the hierarchical structure within and the division of functions across, the Trading Participant. Its purpose is to provide a clear and accurate picture of:~~

- ~~which department is responsible for each business function.~~
- ~~the levels of responsibility and reporting structure within the department.~~
- ~~the levels of responsibility and reporting structure for the heads of department.~~
- ~~the levels of responsibility and reporting structure for the executive director or chief executive officer.~~

~~ii. *Managerial Control*~~

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~~This control includes all manner of supervisory that is exercised by senior management.~~

~~iii. *Segregation of duties*~~

~~The segregation of duties is a crucial method of management control. It involves allocating certain tasks within a business activity amongst the employees in such a manner that one employee's task acts as a check and balance over another employee's task. This ensures that the activities of a Trading Participant are being carried out in a proper and authorised manner and helps prevent the occurrence of fraudulent activities. In a Trading Participant, the usual examples of segregation are between:~~

- ~~procurement of clients and credit risk analysis~~
- ~~trading activities and dealing duties and settlement transactions~~
- ~~funds transfer and transaction booking~~
- ~~daily maintenance of general ledger balance and validation of general ledger balance~~
- ~~maintenance of record balance and physical release of collateral~~

~~The size of certain Trading Participants may make it impracticable to separate tasks within an activity to 2 or more employees. The management will then have to rely on other methods of control such as audits and management reviews and conduct these on a frequent and in-depth basis.~~

~~iv. *Supervisory control*~~

~~Authorised and appropriate qualified personnel should independently supervise all activities~~

~~v. *Review, authorisation and approval*~~

~~All transactions should require approval by an appropriate authorised official. Approval limits should commensurate with the level of each individual's degree of authority. All transactions must be properly documented to provide for review and accountability.~~

~~vi. *Independent review*~~

~~An independent review conducted by an identified personnel functions to ensure that a task or process is carried out properly and efficiently.~~

~~vii. *Accounting control and arithmetical accuracy*~~

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~~Accounting control is essentially a system for checking the accuracy of the information contained in the accounting records and books of the company on a daily basis. Accounting control activities encompass verifying the arithmetical methods used and their results as shown by the figures in financial statements such as account totals and trial balances, proving control account balances and performing reconciliations.~~

~~viii. *Physical security*~~

~~This control relates to the custody and safeguarding of assets, and restriction of access to business premises, systems and departmental records.~~

~~i) maintain comprehensive documentation and written procedures on the supervisory and compliance system ("Written Procedures"). These procedures must be regularly updated to take into account any changes that may occur in the current regulatory framework. These procedures and any amendments in it must be effectively disseminated and enforced throughout the Trading Participant. In addition, the Trading Participant is to maintain an internal record of all persons designated as supervisory personnel and those delegated with supervisory functions, including the dates for which such designation was effective.~~

~~j) establish written procedures of all transactions and correspondence of its Registered Representatives pertaining to the solicitation or execution of any transaction.~~

~~3.2 Compliance responsibilities~~

~~(1) Management is responsible for setting the tone of the Trading Participant to promote a compliance culture within the entity. It is imperative that management provides support to the compliance function and actions taken by management must be indicative of this. Weaknesses in the Trading Participant' internal controls or inefficiencies in operating procedures must be identified and rectified immediately. Non-compliance must be dealt with to ensure that the breach will not occur again.~~

~~(2) It is the responsibility of the staff to comply with relevant industry laws, and internal control policies and procedures set up by the Trading Participant. Both management and staff must bear in mind that compliance is everyone's responsibility. An ethos of professionalism and best practice which is essential for an effective compliance can only be achieved if everyone plays his/her part rather than relying just on the compliance officer or compliance department.~~

~~(3) The ultimate responsibility for proper supervision and compliance rests with the Trading Participant and its board of directors. The compliance officer facilitates the attainment of these objectives and does not relieve the Trading Participant or its board of directors of any of its responsibilities. The formulation of supervisory or compliance programmes may be within the compliance officer's job function but the effective implementation and maintenance of such programmes lies with the Trading Participant and its board of~~

~~directors. Any failure to effectively supervise and ensure compliance by the Trading Participant or its employees will be deemed a failure on the part of the Trading Participant and its board of directors.~~

~~4. ROLE OF THE COMPLIANCE OFFICER~~

~~4.1 An independent function~~

~~(1) The compliance officer acts as the "conduit" through which a Trading Participant achieves the compliance objectives, whilst proving an independent check and balance within the Trading Participant, thereby ensuring that its activities are in compliance with the relevant securities laws, rules, regulations, directives, guidelines, policies and procedures.~~

~~(2) To carry out his duties without any conflict of interest, the compliance officer must be independent of the back and the front offices. He must not have sales and operational functions, and must not be directly involved in trading (e.g. he must not be allowed to solicit or execute any orders on behalf of client), settlement, funding, processing or reconciliation activities of a Trading Participant, and should not act in a manner which may compromise his function and position. He should only be engaged in the compliance function. He must not engage in personal dealing in derivatives.~~

~~4.2 Role of the compliance officer in relation to other departments and functions within the organisation~~

~~(1) The compliance officer undertakes an overall supervisory responsibility over the trading and operational activities of a Trading Participant. He monitors on-going business activities on a pro-active basis to ensure compliance by the Trading Participant. He oversees and supplements other supervisory measures already in place within a Trading Participant and ensures that the relevant supervisors/Heads of Department perform their supervisory responsibilities effectively. However, the compliance officer does not relieve any supervisor/Head of Department of their responsibilities. The burden of executing designated job functions still remains with the respective supervisors/Heads of Department.~~

~~(2) In this respect, the compliance officer should keep in constant communication and work closely with all supervisory heads within the Trading Participant's structure, with a view to supplementing existing reviews of the supervisors and ensuring that the necessary policies and procedures are in place to effect proper supervision of the respective departments.~~

~~(3) The compliance officer and the internal audit department should strive to complement each other and work towards achieving a high standard of compliance. It is important to note that the compliance officer does not resume or take over the duties and functions of any of the other departments within the Trading Participant.~~

~~4.3 Role of the compliance officer in relation to the board of directors~~

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~~(1) The compliance officer must report directly to the board of directors of the Trading Participant. He should have access to the board of directors to report, update, inform and make recommendations on all matters pertaining to compliance, including events of non-compliance. However, in the course of his duties, the compliance officer may bring compliance matters to the attention of the Executive Director or other senior management personnel so as to enable appropriate action to be taken.~~

~~(2) The compliance officer must submit monthly written reports to the board of directors on all matters pertaining to compliance, including matters that had been brought to the attention of the Executive Director or other senior management personnel and the actions taken. The board of directors must deliberate matters reported to it by the compliance officer at its proper meeting so that appropriate action or decision can be taken. Proper records of such deliberations must be maintained.~~

~~(3) To maintain the independence of the compliance officer, his performance should preferably be appraised by the board of directors.~~

~~4.4 Duties and Responsibilities of the compliance officer~~

~~(1) The main duties and responsibilities of the compliance officer are summarised below:~~

~~a) to advise on compliance matters~~

~~The compliance officer has the responsibility to ensure compliance with all relevant laws, rules, regulations, directives, guidelines, policies and procedures.~~

~~b) to review the adequacy of internal controls and risk management system~~

~~The compliance officer must continually review the adequacy of the Trading Participant's internal control system, which includes the risk management system, in light of changes in internal and external conditions.~~

~~c) to review, monitor and supervise other supervisory measures to ensure compliance~~

~~One of the ways to ensure compliance by all levels of staff is to have effective monitoring which should cover front office, back office and accounting activities. It is the responsibility of the supervisors/Department Heads to ensure compliance by their staff members. In this respect, it is the duty of compliance officer to review the adequacy of the supervisory measures undertaken by the supervisors/Department Heads. The frequency of reviewing and monitoring should be determined by assessing the level of risk involved, and the frequency and nature of changes in the operating environment. The reviewing and monitoring should also focus on areas of risk. A checklist should be used for such purposes.~~

~~d) to assist in training and educating staff members on compliance matters~~

~~Training is critical to the successful implementation of a compliance culture. All new recruits and existing staff members must be adequately trained and equipped with the necessary capabilities to carry out the responsibilities assigned to them. The compliance officer must assist in the training and educating of staff members on compliance related aspects of their jobs and should ensure that they are kept up-to-date with changes in regulatory requirements.~~

~~e) to report to the board of directors~~

~~It is the duty of the compliance officer to inform and report to the board of directors on all matters pertaining to compliance at least once a month. However, he should immediately report to the board of directors and the relevant Exchange(s) if a matter requires urgent attention, e.g. breaches of the laws, and matters pertaining to segregation of clients' assets and risk position of the Trading Participant.~~

~~f) to liaise with the regulatory bodies on compliance matters~~

~~Due to the independence of the compliance officer's functions, he is the most suitable personnel in the Trading Participant to play the role of liaison officer between the Trading Participants and the regulators for the purpose of information sharing, clarification of rules and regulations, requests for advice, and reporting of incidence of non-compliance.~~

~~(**Annex I** elaborates the main duties and responsibilities of the compliance officer)~~

~~5. ESSENTIAL SKILLS REQUIRED OF A COMPLIANCE OFFICER~~

~~(1) It is important that the right person is employed as a compliance officer. The individual must have at least a minimum level of competence in the particular activities they are required to monitor, and must also be a person equipped with authority to carry out his responsibilities as a compliance officer and of an appropriate level of seniority to act independently and to effect decisions. He must have unlimited access to all information and records in relation to the Trading Participants business activities and must be authorised to question any employee regarding any conduct, business practice, ethical matter or any other issue which is relevant to the discharging of his duties.~~

~~(2) A compliance officer needs to have proper professional qualifications and experience appropriate to the duties that he/she is expected to perform.~~

~~(3) A compliance officer needs to have some ***technical expertise*** in the areas of business he/she is to monitor, for example, general principles relating to the use of derivatives products in hedging, market making, portfolio management, arbitrage and yield enhancement, as well as the risks involved, services offered by the Trading Participant and market practices. He/she must be ***professionally competent*** in assessing industry rules that apply to the business and able to interpret them in a~~

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~~practical business way.~~

~~(4) As the compliance officer needs to work closely with colleagues within the Trading Participant and with the regulators, it is essential that Compliance Officer possesses ***good communication and interpersonal skills***. He/she must be a good listener, open and approachable and have negotiation skills to be able to put over an argument in persuasive rather than dictatorial terms.~~

~~(5) A compliance officer must be able to ***apply knowledge and experience*** gained to the business he/she works in and understand the critical problems and constraints faced by the business in order to gain credibility when discussing issues with management. Nevertheless, he/she must maintain an ***independent frame of mind*** and be able to make an independent decision whether to report or discuss with the board of directors and regulators on particular issues as seen appropriate.~~

~~6. COMPLIANCE MANUAL~~

~~(1) A Trading Participant must establish and maintain a comprehensive "Compliance Manual" tailored to its respective needs and must be approved by its board of directors. Such manual will be subject to review for adequacy by the compliance officer, who will then ensure that the requirements in the manual are adhered to.~~

~~(2) The Compliance Manual must elaborate on the practical applications of a compliance officer's detailed functions. The manual must specify among others his monitoring, supervisory and review procedures in relation to all his functions.~~

~~(3) The manual must among others include:~~

~~(a) the outline for the compliance policies, procedures and controls of the Trading Participant, to safeguard the Trading Participant and its customers from serious risks of loss and defalcation; and~~

~~(b) a Code of Conduct outlining standards of personal integrity expected from the staff.~~

~~(4) The compliance officer must ensure the following:~~

~~(a) the procedures established in the manual are adequate. Adequate procedures are those designated to meet industry standards, regulatory requirements, and the circumstances of the Trading Participant;~~

~~(b) the compliance procedures are designed to anticipate, as far as possible, the activities most likely to result in misconduct by the Trading Participant;~~

~~(c) each compliance programme must be appropriate for the size and nature of the Trading Participant;~~

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~~(d) the compliance procedures established are effectively communicated within the Trading Participant;~~

~~(e) the manual be subjected to regular periodic review or whenever there are major changes to the relevant Securities laws, rules, and regulations;~~

~~(f) once the compliance procedures are established, the compliance officer must ensure that the compliance procedures are monitored and enforced.~~

~~7. CONCLUSION~~

~~(1) Obviously, compliance will result in a lower incidence of disciplinary actions imposed on a Trading Participant e.g. fines and suspension from trading which may disrupt the business as well as damage the Trading Participant's reputation. More importantly, compliance by way of establishing control principles like segregation of duties and independent review serves to protect the Trading Participant's business assets by decreasing the occurrences of unintentional errors or outright fraud through quick detection and rectification.~~

~~(2) The effective penetration of a proper compliance culture into all business and administrative units of a Trading Participant will bring about lower operational risk, facilitate earlier detection of market risk or concentration risk result in a higher level of operational efficiency which in turn will translate into a reduction of operating costs and financial risk.~~

~~ANNEX I – DUTIES AND RESPONSIBILITIES OF THE COMPLIANCE OFFICER~~

~~In order to maintain high standards of business conduct, strong internal controls and ensuring compliance with laws, rules and regulations, a Trading Participant is required to have a compliance officer to manage the compliance aspects of its dealing in derivatives business. The main duties and responsibilities of the compliance officer are:~~

~~a) to advise on compliance matters~~

~~In carrying out the above duty, the compliance officer should:~~

~~i. understand all relevant laws, rules, regulations, directives, guidelines, policies and procedures, and changes thereto, and interpreting them with regards to the size and complexity of the Trading Participant;~~

~~ii. advise all personnel of the Trading Participant on how these requirements can be translated into practical procedures and all matters compliance; and~~

~~iii. ensure that the Trading Participant has policies and procedures to govern all key activities.~~

~~The compliance officer has the responsibility for ensuring that compliance is met within all business~~

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~~areas.~~

~~b) to review the adequacy of internal controls and risk management system~~

~~Internal control is defined as follows:~~

~~"*Internal control is the process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:*~~

~~*a) reliability of financial reporting*~~
~~*b) compliance with applicable laws and regulations and*~~
~~*c) effectiveness and efficiency of operations"*~~

~~Internal control comprises 5 interrelated elements:~~
~~i. management oversight and the control culture~~
~~ii. risk assessment~~
~~iii. control activities~~
~~iv. information and communication and~~
~~v. monitoring activities~~

~~It is the responsibility of Trading Participant to maintain a sound system of internal controls, which covers not only financial controls but operational and compliance controls, and risk management.~~

~~In reviewing the adequacy of the internal control system with the Trading Participant, the compliance officer needs to consider the degree of existence and effectiveness of the following control factors:~~

~~i. *evidence of control operation*~~

~~Once a control is introduced in the Trading Participant, its effectiveness and reliability largely depend on the ability of the Trading Participant to ensure and confirm that it is being operated. This confirmation should ideally take the form of documentary evidence such as a report or acknowledgement in writing from the person operating that control. The absence of such documentary evidence increases the risk that the control is not being operated and undermines the Trading Participant's ability to detect any breaches of the control.~~

~~ii. *preventive and detective control*~~

~~The purpose of having controls is to discourage, and "blow the whistle" on improper or unauthorised activities. These preventive and detective elements can be put in place by locating controls beginning from the point at which the risk first arises within an activity or process. This will reduce the time between the occurrence of the unauthorised activity~~

~~and the whistle being blown, and prevent the situation from becoming worse and irreparable without detection. A common example of this is the exposure or position limit that an individual Trading Participant is assigned by the management. Any breach in the limit is not left to be detected and reported by the Trading Participant itself, but also at the point of the position-keepers, limit monitors and risk management officers who would typically have controls at their end to ensure that they complete their tasks by the end of the day or before the beginning of the following trading day. This means that the breach should not continue undetected beyond a day and the situation should not have the opportunity to worsen past that day.~~

~~iii. *addressing missing controls or weak ones*~~

~~There should be procedures for improving or modifying the control system where weaknesses or gaps in the controls are discovered. The process of initiating and implementing the improvements should be prompt to reduce the Trading Participant's exposure to the weakness or gap. The Trading Participant should also be able to assess and quantify the risk to which it is exposed as a result of the weakness or gap.~~

~~The derivatives industry is a dynamic, rapidly evolving industry and as such, the compliance officer must continually review the adequacy of the Trading Participant's internal control system, which includes the risk management system, in light of changes in internal and external conditions. In this respect, the compliance officer must review the assessment of the internal audit department on the adequacy of the Trading Participant's internal controls.~~

~~**Annex II** lists some functional control standards of key dealing in derivatives activities that will serve as a guide for reviewing the Trading Participant's overall internal control system.~~

~~***c) to review, monitor and supervise other supervisory measures to ensure compliance***~~

~~One of the ways to ensure compliance by all levels of staff is to have effective reviewing and monitoring. It is the responsibility of the supervisors/Department Heads to ensure compliance by their staff members. In this respect, it is the duty of the compliance officer to review the adequacy of the supervisory measures undertaken by the supervisors/ Department Heads. Compliance review and monitoring should cover front office, back office and accounting activities. Reviewing, monitoring and supervision include:~~

~~i. review of control procedures to ensure derivatives activities are conducted according to existing policies and guidelines laid down by the board of directors and management;~~

~~ii. review of procedures carried out in opening and approving the opening of client accounts and ensure compliance with Rules, Directives and relevant statutory requirements;~~

~~iii. review of operations to ensure that trading rules such as timely allocation of trades and~~

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~~transaction confirmations;~~

~~iv. review execution of trades to ensure compliance with the Exchange's order taking rules;~~

~~v. review of clients' deposits and withdrawals to ensure compliance with laws and business rules;~~

~~vi. review of accounting entries processing and general ledger account validation;~~

~~vii. review of general ledger account opening process. A control process must exist to prevent creating dummy or suspense ledger accounts which may be used to park unauthorised or loss making trades;~~

~~viii. review of reconciliation activities of the back office;~~

~~ix. ensuring proper segregation of clients' funds;~~

~~x. review correspondence between Registered Representatives and clients pertaining to solicitation or execution of contracts from time to time;~~

~~xi. review of Adjusted Net Capital level and any other internal or external minimum capital standard and ensure the Trading Participant is able to meet minimum financial requirements at all times;~~

~~xii. review of error trades;~~

~~xiii. review proprietary account to ensure compliance with credit/position limits imposed and that over-limits are reported to management;~~

~~xiv. review discretionary accounts to ensure compliance with Exchanges' business rules and that transaction are not in excess of clients' financial resources;~~

~~xv. review of all proprietary account and discretionary accounts transactions, and ensure there is no conflict of interests during the execution of client trades and house trades;~~

~~xvi. review clients' position limits to ensure compliance with Exchange imposed position limits and reportable position limit;~~

~~xvii. review margin calls issued to clients to ensure collection of margins are within the stipulated time frame;~~

~~xviii. review of employee transactions to ensure that such transactions are authorised, executed and recorded in compliance with proper procedures;~~

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~~xix. review of client's complaints, i.e. analyse trends in complaints, the general causes and the average length of time taken to respond to and resolve clients' complaints. The compliance officer should review the handling of complaints by a designated officer to ensure that the handing of complaints, including any subsequent investigation and action taken, are in compliance with proper procedures;~~

~~xx. review of all advertisements, sales literature and any other types of information pertaining to recommendations/business disseminated to the client/public to ensure accuracy and compliance with relevant laws, rules and regulations, before being published and made accessible to the public; and~~

~~xxi. follow up on audit findings. The compliance officer should ensure that audit finds raised by internal, external and regulatory auditors are addressed and rectified promptly.~~

~~The frequency of reviewing and monitoring should be determined by assessing the level of risk involved, and the frequency and nature changes occurring in the operating environment. The reviewing and monitoring programme may be carried out daily, weekly or monthly, or as issues-based reviews of particular risk issues identified from past reviewing and monitoring or issues raised by the auditors during periodic audits. Ongoing reviewing and monitoring activities can offer the advantage of quickly detecting and correcting deficiencies in the system. Examples of such ongoing activities include the review and monitoring programme effectively, the compliance officer should have some measures such as a checklist to confirm that the reviewing and monitoring process have been performed and to record any deficiencies found. The checklist could also be used as a reference when having discussions with staff and management. A sample of reviewing and monitoring checklist is shown in **Annex III**.~~

~~When performing the reviewing and monitoring process, the compliance officer should focus on areas of risk. The compliance officer should assess the risk in financial terms if activities are not controlled properly or a critical control step is missing, examples:~~

~~i. risk of loss resulting from weaknesses in credit control and/or portfolio concentration- counterparty default on transactions in the process of being settled and where value had been delivered to the counterparty but not yet received in return;~~

~~ii. risk of loss resulting from weaknesses in control of liquidity- failure to meet its payment obligations on settlement dates or in the event of margin calls;~~

~~iii. risk of loss resulting from weaknesses in internal control- inaccurate financial information reported as a result of incorrect data used to value financial positions;~~

~~iv. risk of loss resulting from weaknesses in legal control- contracts or collateral not legally enforceable and exercisable.~~

~~In this regard, the compliance officer should also:~~

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~~i. review the effectiveness of internal controls relevant to measuring, reporting and limiting risks~~

~~ii. review the credit approval process to ensure that the risks of specific products are adequately captured and the credit approval procedures are followed. As a matter of general policy, business with a counterparty should not commence until a credit line has been approved~~

~~iii. review risk exposure and concentration of risk, ensure that trading activities are within the limits approved by the board of directors and adequate capital is maintained to support derivative activities~~

~~iv. review to ensure that margin policy complies with the Exchange's rules on margin trading~~

~~v. review the legal documentation process and ensure guidelines and procedures are followed and consider the quality, marketability and enforceability of collateral pledged~~

~~The reviewing and monitoring process would only be effective if the compliance officer holds regular meetings with management and staff involved to review past findings. This is because regular meetings are helpful to review how procedures are working, to consider the weaknesses and any recommendations for change. This will help to establish an effective compliance culture.~~

~~**Annex IV** describes in general some of the risks involved and risk management of exchange-traded derivatives. It serves as a reference for the compliance officer to enhance his/her compliance reviewing and monitoring process.~~

~~***d) to assist in training and educating staff members on compliance matters***~~

~~All new recruits and existing staff members must be adequately trained and equipped with the necessary capabilities to carry out the responsibilities assigned to them. Training is critical to the successful implementation of a compliance culture. The compliance officer must assist in training and educating staff members on compliance related aspects of their jobs and should ensure that they are kept up-to-date with changes in regulatory requirements. Training can comprise both formal and on the job training. Some examples of on the job training that can be conducted by the compliance officer are:~~

~~i. informing staff of weakness found during the compliance review and monitoring process;~~

~~ii. explaining regulatory requirements and the consequences if such requirements are not met; and~~

~~iii. disseminate information that the regulators have communicated through circulars, e.g. changes in regulatory requirements or disciplinary action taken by the regulators.~~

~~***e) to report to the board of directors***~~

~~A timely information reporting system will foster an environment of compliant practices. It is duty of the compliance officer to inform and report to the board of directors on all matters pertaining~~

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~~to compliance at least once a month. However, the compliance officer should immediately report to the board of directors and the relevant Exchange(s) if a matter requires urgent attention, e.g. breaches of the laws, and matters pertaining to segregation of clients' assets and risk position of the Trading Participant.~~

~~The compliance report should report at the minimum, the following issues:~~

~~i. *credit exposure*~~
~~The board of directors should be informed of any breach in limits that has occurred and follow-up actions taken, any overdue payments and follow-up on non-payments.~~

~~ii. *funding*~~
~~The board of directors should be apprised of the level of the organisation's Adjusted Net Capital and the impact of business activities on the organisation's overall liquidity position.~~

~~iii. *collateral received*~~
~~The board of directors should be informed of the type and financial exposure of collateral pledged by clients and measures taken by the organisation to satisfy itself that the documentation has been appropriately reviewed.~~

~~iv. *error trades*~~
~~The board of directors should be informed in detail on how the error trades occurred and the amount of profit/loss absorbed by the organisation.~~

~~v. *segregation of clients' assets*~~
~~The board of directors should be informed of any deficiency in clients' segregated assets.~~

~~vi. *audit findings by the internal, external and regulatory audits*~~
~~The board of directors should be informed of the audit finds raised by the internal. External and regulatory audits and the actions taken by management to address the issues highlighted.~~

~~vii. *other compliance issues and amendments to laws, rules and regulations*~~

~~The compliance officer is responsible for ensuring that new compliance issues are properly addressed and reported to the board of directors, and compliance risks are brought to the board of directors' attention. The compliance officer must also report to the board of directors matters that had been brought to the attention of the Executive Director or other senior management personnel and the actions taken.~~

~~viii. *Other matters*~~
~~The board of directors should also be informed of situations of potential conflicts of interests.~~

~~***f) to liaise with the regulatory bodies on compliance matters***~~

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~~Managing the Trading Participant's relationship with the regulator is very important. The compliance officer is the most suitable personnel in the organisation to play the role of liaison officer between the Trading Participant and the regulators due to the independence of his/her functions. Report must be cultivated to facilitate information sharing, clarification of rules and regulations and requests for advice. Consequently the compliance officer should:~~

~~i. ensure monthly financial statements are submitted to the regulators within the stipulated time;~~

~~ii. inform the regulators immediately of any non-compliance and the actions or remedy to be taken by the organisation;~~

~~iii. inform the regulators of any constitutional changes in relation to the organisation's operations and any changes affecting the Capital Markets Services Licence or licences issued to its Registered Representatives;~~

~~iv. inform the regulators immediately of any circumstances affecting the organisation's solvency or any condition that would materially impair its ability to meet any of its obligations; and~~

~~v. be able to produce documents and information as and when requested by regulators and is answerable to any queries that the regulators may have in relation to his/her compliance duties and responsibilities.~~

~~The compliance officer is encouraged to maintain routine contact with the regulators to discuss contentious issues and seek advice and suggestions to problems encountered.~~

~~However, the regulators are not obliged to provide solutions, as this is the responsibility of the broker.~~

~~Finally, the compliance officer should understand the reason inspection visits by regulators are conducted and be aware of the frequency of such visits. The purpose of audit inspections conducted by regulators are as follows:~~

~~That the Trading Participants and Clearing Participants:~~

~~i. comply with the relevant laws, rules, regulations, directives, guidelines, policies and procedures;~~

~~ii. maintain adequate internal controls in all areas;~~

~~iii. protect clients' assets by maintaining proper segregation;~~

~~iv. maintain proper records that support and explain its activities, e.g. trading, settlement records, etc.;~~

~~v. maintain a proper and up-to-date operations manual;~~

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~~vi. have experienced management, qualified staff and an adequate back office system to carry out the business of dealing in derivatives;~~

~~vii. safeguard the company's and its clients' assets against unauthorised use or disposal by having proper controls in place;~~

~~viii. maintain proper accounting records i.e. all transactions reported in the monthly financial reports are fairly stated, supported by relevant documents, and classified and disclosed in accordance with the Rules; and~~

~~ix. maintain adequate capital and financial resources to support its trading activities.~~

~~Regulators assess internal controls and risk management as the focus is on detective and preventive measures. A reactive approach is not deemed appropriate in this industry due to the high risks involved due to the inherent leverage. Hence, during the inspection visit, the regulators expect, at the minimum the following, in order to conduct the audit in an efficient and effective manner:~~

~~i. availability of front office, back office and accounting records;~~

~~ii. all records have been maintained properly, in compliance with rules and regulations and can be substantiated;~~

~~iii. trading activities conducted comply with the rules and regulations;~~

~~iv. accurate and full information to be given to all inquiries; and~~

~~v. co-operation from all levels of staff.~~

~~The compliance officer therefore should build positive long-term relationships with the regulators and is encouraged to exchange ideas on good compliance principles and activities to further develop a positive compliance culture across the industry.~~

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~~**ANNEX II FUNCTIONAL CONTROL STANDARDS FOR DEALING IN DERIVATIVES**~~

~~The need for an effective system of internal control is more relevant and important to a business today. Technology and the growth of globalised institutions have not only speeded up execution and trading processes worldwide and the transmission of information across borders, but they have arguably also introduced a new dimension of systemic risk of a magnitude that regulators, analysts and economics are still grappling to quantify. A good set of systems and internal controls may not eliminate external systemic risk but they will help a firm to detect and quantify the risk faster, giving the firm added valuable time to plan and respond to risk. Apart from systemic risk, good internal controls will help to substantially minimise a firm's operations risk.~~

~~Great attention has been placed on the need for effective control in establishing the rules and other arrangements for the operation of the derivatives market itself. This section has set down the basic functional control standards that should be established across derivatives activities:~~

~~**Managerial oversight and understanding**~~

~~It is the responsibility of the board of directors to establish policies and procedures, and maintain a sound system of internal controls, which covers not only financial controls but operational and compliance controls, and risk management. It is the responsibility of senior management to effectively implement all policies and procedures set by the board of directors. However, the ultimate responsibility or control effectiveness in the organisation will rest with the board of directors. Control is exercised through the issuance of internal control policy and procedures and regular performance monitoring by senior management.~~

~~It is fundamentally important that senior management fully understand and are familiar with all types of risk involved in derivatives activities. They must be aware of and understand the nature of profitable activity and whether profit expectations are commensurate with the risk level of the activity.~~

~~**Segregation of duties**~~

~~There must be a high degree of segregation of duties between front office, back office and accounting:~~

~~***Front office***~~
~~The following functions are not part of the day-to-day activities of Registered Representatives:~~
- ~~confirmation of contract notes and monthly statements~~
- ~~monitoring and prescribing of trading, position and credit limits, except for ensuring that clients operate within the limits imposed by the Credit Control Department/company~~
- ~~authorisation of increase in limits or breaches of controls~~
- ~~opening of general ledger accounts. This control is intended to prevent Registered Representatives from setting up dummy or suspense accounts for storing unauthorised trades. The Registered Representative's request to open an account and the justification for doing so is checked by another employee.~~
- ~~accounting entries~~
- ~~transfer of funds~~

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- ~~reconciliations relating to the organisation's trading position and financial statements~~

~~In addition to the day-to-day supervision of the Registered Representative's trading practices by a senior personnel who is familiar with trading practices, there must also be a review by the compliance officer. The function of the supervisor is to monitor the following activities (where applicable) on a real-time basis:~~

- ~~open positions of each Registered Representative~~
- ~~position limits and their status~~
- ~~compliance with time requirements for placing trade orders and entering trades into the system~~
- ~~sequence of placements of orders and trade entries~~
- ~~trading practices~~
- ~~degree of error in placing or inputting trades application of internal and external business ethics and standards~~
- ~~compliance with trading room policy~~
- ~~intra-day market activities particularly market movements and their effect on the financial positions of the trades~~

~~Dealing Room Security:~~

- ~~access to the dealing room should be restricted to only properly authorised personnel~~
- ~~entry to the dealing room should be restricted to, for example, card key access~~
- ~~visitors to the dealing floor should be properly supervised~~

~~Client complaints should be monitored by the front office in conjunction with the back office customer service unit. Where client complaints indicate a systemic weakness in the underlying process, steps should be taken to resolve the matter internally and to communicate with the customer to reassure them that action is being taken.~~

~~Back Office~~

~~The back office must have a comprehensive policy and procedures manual. The policy and procedures manual must be up to date in all respects. Back office procedures must ensure the completeness and accuracy of:~~

- ~~trade transactions posted to the back office system~~
- ~~funds transfer processing~~
- ~~trade adjustments, reversals and corrections~~
- ~~other revenue posting (such as fees)~~

~~To ensure all trade positions are identified and reconciled:~~

- ~~positions reconciliation must be completed independently from the dealing room and must be completed before the start of the next trading day~~
- ~~all positions must be reconciled~~
- ~~all reconciling items must be investigated promptly~~
- ~~unreconciling items must be brought to the attention of the Head of Dealing~~
- ~~a copy of the position reconciliation must be retained as evidence of work done~~

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~~To ensure accuracy of back office records:~~

- ~~a contract note should be sent to the customer for every trade~~
- ~~a daily system audit trail must be produced which lists in detail all changes made to previously input data (regardless of the data field concerned)~~
- ~~back office transactions must be completed in all respects and on a timely basis~~
- ~~supervisory controls over funds transfer should be adequate to prevent unauthorised payments being made~~
- ~~control procedures must be established and maintained over instructions received via phone, telex and fax~~
- ~~whenever possible, payment should be based on standing customer's instruction~~
- ~~any settlement instruction not in accordance with standing customer's instruction should be authenticated and approved before payment is made, e.g. call customer for confirmation~~
- ~~all phone calls to customers must be logged and where possible taped for security reasons~~
- ~~procedures must establish for verification of customers' payment instructions~~
- ~~customer instructions must be checked against authorised signature lists~~
- ~~procedures must exist to highlight and report any instruction which require payment to a non-standard or unusual account or address. Further approval and authentication should be required before any payment is made~~
- ~~there should be proper controls over segregation of duties and review and authorisation for payment. The person initiating payment instructions should not for example be able to authorise payment or in charge of accounting entry~~
- ~~the withdrawal amount should be checked prior to payment~~
- ~~payment instructions must be stamped "PAID" after payment is made and be filed securely to prevent resubmission for duplicate payment~~
- ~~controls should be established to ensure collection of margin or follow up action have been taken in the event margin was not paid on time~~
- ~~all documents should be properly filed~~

~~Any errors in processing must be investigated and corrected without delay. An audit trail of processing errors should be maintained to help trace causes, trends and to monitor level of errors. Recurring error and other deficiencies must be brought to management's attention. A corrective action plan should be formulated and implemented as soon as practicable to correct the cause of systemic processing errors.~~

~~To ensure that appropriate collateral is received, monitored, safeguarded against loss and only released under the correct authority, the following controls over the receipt, recording and maintenance of collateral should be practised:~~

- ~~policy and procedures on acceptance of collateral should be established before collateral is received~~
- ~~the circumstances whereby collateral can be used to satisfy an outstanding customer obligation must be clearly stated and this will include an event of default, liquidation or bankruptcy of the counterparty~~
- ~~a legal opinion should be obtained which expressly comments on the adequacy of the security arrangements that are contained in the underlying documentation such that the security is well~~

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~~founded and that off-set can be utilised according to contractual terms~~

- ~~collateral once received, should be verified and details of the collateral should be loaded on the back office system~~
- ~~recording of collateral must be in accordance with the CMSA and must include the following:~~
  ~~a) client name~~
  ~~b) type of collateral received~~
  ~~c) amount (in face value terms)~~
  ~~d) quantity (number of bonds or shares)~~
  ~~e) date of receipt~~
  ~~f) date updated to back office system~~
  ~~g) place of safekeeping~~
- ~~collateral physically received into safekeeping must be placed in a secure place (e.g. fire proof vault)~~
- ~~person who has no authority over the recording process must make receipt into custody of a vault~~
- ~~collateral must be independently reconciled to third party records if relevant~~
- ~~movement in the value of the collateral should be updated on the back office system. Shortfalls should be highlighted. Procedures must be established to ensure that operations identify shortfalls and make the necessary margin calls~~
- ~~collateral should only be released in accordance with contract terms and on instructions from the customer and upon verification that customer obligations have been satisfied~~
- ~~all release instructions must be checked against customer authorisation lists~~
- ~~a final independent review must take place before collateral are released to ensure that:~~
  ~~a) all authentication procedures have been performed~~
  ~~b) sufficient documentation evidence~~

~~Accounting~~

~~Care should be taken to ensure that an appropriate level of segregation of duties exists in respect of the accounting function and that all entries are authorised before data is input to the general ledger. Independent check is a crucial management tool in ensuring accuracy and integrity of accounting information and records.~~

~~To ensure that accounting information are complete, accurate and process on a timely basis, the following accounting controls should be practiced:~~

~~Reconciliation~~

- ~~any accounting related reconciliation must be performed independently, evidenced in writing, verified by independent officer and filed~~
- ~~all reconciling items must be followed up and resolved promptly~~
- ~~unknown difference should be investigated~~
- ~~any write-off of a difference must be approved at the appropriate level of management~~
- ~~problems items in dispute, long dated outstanding items must be highlighted to management~~
- ~~a build-up of reconciling items or unusually high levels must be brought to management's attention for remedial action~~

~~*Inter-company balances*~~

- ~~inter-company receivable and payable balances must be reconciled periodically~~
- ~~balances should be confirmed between parties through the exchange of a periodic statement of the balance~~
- ~~reconciliation differences must be investigated and promptly resolved~~
- ~~the reconciliation process must be documented and verified by an independent officer~~

~~*Documentation and recording of transactions*~~

~~There should be a system of well-designed accounting forms and documents to record all activities.~~

~~The accounting vouchers should capture consistently and completely all the accounting entries with their corresponding account code, nature of the entries, date of the entry, persons who prepared, checked/authorised and posted the entries into the general ledger system. In addition, any supporting documents, e.g. invoices, debit/credit notes and any schedules/computation which support the amount posted into the general ledger should be attached together. All accounting vouchers should be serially numbered or pre-numbered so that it can be used as a reference for the related entries in the general ledger as well as a control to ensure transactions are not omitted from the general ledger.~~

~~The implementation of a proper accounting voucher system would ensure existence of an audit trail and provide accountability to the accounting data captured in the system.~~

~~*Cash*~~

- ~~all cash which should have been received was in fact received and recorded promptly and accurately~~
- ~~cash receipts are deposited on a timely basis~~
- ~~cash disbursements are properly recorded~~
- ~~all disbursements are made by way of issuance of cheque or telegraphic transfer~~
- ~~bank reconciliation be performed by staff not responsible for issuance of cheques or custody of cash~~
- ~~cash balances are maintained at adequate levels~~
- ~~do not permit any one employee to handle a transaction in its entirety~~

~~*Fixed assets*~~

~~A proper fixed asset register should be maintained as this will assist in monitoring each of the fixed assets owned (for example fully depreciated fixed assets). Any additions or disposals of fixed assets should be updated into the fixed asset register promptly and accurately. A system of authorisation requiring senior management approval of all acquisitions and disposal of fixed assets should be established. Depreciation charge per month should be computed based on the depreciation policy adopted, charged into the Profit and Loss Account and updated into the register. A proper capitalisation policy is encouraged in order to avoid assets of insignificant amount being included as fixed assets.~~

~~*Prepayments and accruals*~~

~~A prepayment and accruals schedule should be maintained as this could assist in monitoring of prepayments and accruals amounts~~

~~Others~~

- ~~the potential impact on profit and loss resulting from any problem item should be identified and where necessary a reserve taken for potential expected loss~~
- ~~adjusting entries must be passed to clear resolved items~~
- ~~the creation and use of suspense, error or sundry accounts should be avoided~~

~~Safekeeping of important documents~~

~~For security purposes, all important documents and back up diskettes should be kept in fire proof safe or at a secure location.~~

~~Internal control over electronic data processing (EDP)~~

~~In a manual accounting system, an important element of internal control consists of division of duties among several persons in such a manner that the work of one employee is to verify that of another, to avoid one person handling a transaction in its entirety. If an electronic data processing system is installed, machines may do work formerly done by several employees. Despite the integration of several functions in an EDP system, the importance of internal control is not in the least diminished.~~

~~a) Control over input~~

~~Input controls are designed to provide assurance that data received for processing represent properly authorised transactions and are accurate and complete when read in the computer. Control over input begins with proper authorisation and initiation of the transactions to be processed. When transaction data are originally recorded on 'hard copy' source documents, the appropriate person initiating the document should indicate authorisation. In online systems transaction data may be entered directly into the computer from remote terminal device located in the departments initiating the transactions. In these cases, access to the terminals must be limited to those persons authorised to initiate transactions.~~

~~If transactions documents are collected into batches for processing in sequence as on batch, input controls are necessary in batch processing to determine that no data is lost or added to the batch.~~

~~The sequence of serial numbers of source documents comprising each batch should be accounted for.~~

~~b) Control over processing~~

~~Processing controls are designed to assure the reliability and accuracy of data processing. A major method of achieving control over processing is the use of program controls, which are written into the computer programs such as item count, control total, validity, self-checking number etc.~~

~~c) Control over input~~

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~~Output controls are designed to assure the reliability of computer output and to determine that output is distributed only to authorised personnel. Control over output begins with independent verification and follow up on exceptions and errors reported.~~

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~~**ANNEX III COMPLIANCE CHECKLIST (SAMPLE)**~~

~~(This checklist is intended to provide guidance and is not exhaustive).~~

~~**COMPLIANCE CHECKLIST as at ___________ (date)**~~

~~**DAILY FUNCTIONS:**~~	~~**PERFORMED YES/NO**~~	~~**REMARKS**~~
~~**Beginning of day:**~~		
~~a) Check with Back Office Department whether any margin call from the Clearing House and appropriate action has been taken~~		
~~b) Check back office report to ensure follow up actions have been done on clients having margin call or breach position limits and ensure no breach of Rules~~		
~~c) Check to ensure daily bank reconciliation, back office reconciliation and other reconciliations have been performed~~		
~~d) Check to ensure contract notes are printed and issued to clients as prescribed by the Rules and CMSA~~		
~~**Mid of day:**~~		
~~a) Check and review all transactions executed~~		
~~b) Check and review clients opening position to ensure the positions do not exceed the limit determined by the board of directors~~		
~~**End of day:**~~		
~~a) Check whether all cash transactions related to clients accounts were updated into the back office system on a timely basis and all client deposits are banked into segregated bank by T+1~~		
~~b) Check whether all transactions relating to give up trades and position transfer were updated in the back office system on a timely basis~~		
~~c) Review error reports, if any and ensure error trades are closed out immediately, review all trade amendments~~		
~~d) Review the ANC to ensure its compliance with the minimum financial requirement~~		

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~~**WEEKLY FUNCTIONS**~~	~~**PERFORMED YES/NO**~~	~~**REMARKS**~~
~~Check accounting vouchers to ensure all vouchers are prepared during the week are properly prepared, checked and approved.~~		
~~**MONTHLY FUNCTIONS:**~~		
~~Check to ensure Back Office Department print and send the monthly statements to clients an ensure compliance with the Rules and CMSA~~		
~~Check the monthly financial reports to ensure accuracy before submit to the relevant authorities~~		
~~Preparation of Compliance report~~		

~~**AD HOC FUNCTIONS**~~	~~**PERFORMED YES/NO**~~	~~**REMARKS**~~
~~Check to ensure annual subscription and fidelity fund contributions are paid on time to the Exchange~~		
~~Check to ensure annual report is submitted to the Exchange within stipulated time~~		
~~Opening of new accounts:~~ ~~i. Check to ensure initial deposit received/cleared before commencement of trading (or as company's policy)~~ ~~ii. Check to ensure supporting documents required are available, approved by ED~~ ~~iii. Check to ensure that the client's background and financial information verification is carried out~~		
~~Advertisement~~ ~~i. Check to ensure that the material issued been reviewed and approved in advance (by CO)~~ ~~ii. Check to ensure copies of all advertisements, sales literature and educational materials, the names of~~		

~~person approved the materials and the source of recommendation have been retained~~		
~~Check to ensure that the operation manual has been updated to reflect the current procedures practised by the staff~~		
~~Check to ensure audit findings raised in the audit reports have been followed-up and practised~~		
~~Check to ensure the Trading Participant's Capital Markets and Services Licences and the Registered Representative's Capital Markets Services Representative's Licence for dealing in derivatives have been renewed~~		
~~Disseminate information throughout the organisation upon receipt of circulars from the Exchange and other regulatory bodies~~		
~~Review internal controls when necessary e.g. reorganisation changes in size of the operations~~		
~~Review closing of accounts~~		

~~ANNEX IV TYPES OF RISK AND RISK MANAGEMENT OF EXCHANGE TRADE DERIVATIVES~~

~~The basic risk associated with exchange traded derivatives transactions are credit risk, market risk, liquidity risk, operations risk and legal risk.~~

~~(A) Credit risk~~

~~(1) Broadly defined, credit risk is the risk that the counterparty fails to perform an obligation to the Trading Participant. The Trading Participant should evaluate both settlement and pre-settlement credit risk at the counterparty level across the products. On settlement day, the exposure to counterparty default may equal the full value of any cash flows or securities the Trading Participant is to receive. Prior to settlement, credit risk is measured as the sum of the replacement cost of the position, plus an estimate of the Trading Participant's potential future exposure from the instrument as a result of market changes.~~

~~(2) The first line of defence that is employed in countering the threat of counterparty default is internal controls that ensure credit risk is assessed prior to entering into transactions with a given counterparty. Assessment of credit risk posed by a potential counterparty must involve taking into consideration the~~

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~~capital adequacy of the party, its debt/equity ratio, its assets/liabilities ratio with particular emphasis on liquidity assets, its earning ratio and the types of assets held and liabilities incurred by that party.~~

~~(3) Certain credit circumstances structure may be used to reduce the credit exposure dealing with counterparties. Such structure may include collateral or third party guarantees. In such cases, a Trading Participant's credit exposure should reflect these risk-reducing features only to the extent that the resource provisions are legally enforceable in all relevant jurisdictions. The Trading Participant should be able to demonstrate that it has exercised due diligence in evaluating the enforceability of these resource provisions and provides adequate protection to the Trading Participant.~~

~~(4) Credit limits should be established for all counterparties with whom the Trading Participant conducts business. As a matter of policy, business with counterparty should not commence until a credit line has been approved. It is important that Trading Participant set up an independent credit risk management team responsibility for:~~

~~a) approving credit exposure measurement standards~~
~~b) setting credit limits and monitoring their use~~
~~c) reviewing credit and concentration of credit risk~~
~~d) reviewing and monitoring risk reduction arrangements.~~

~~(5) Credit exposure should be monitored continuously and compared to the approved limits. Management should be informed of any breach that has occurred. Follow-up action on unresolved excess exposures should be updated and reported to management. For settlement risk, the settlement process should be monitored daily and overdue payments be reported to management daily. Follow-up action on non payment should be updated and reported to management.~~

~~**(B) Market risk**~~

~~(1) Market risk is the risk to a Trading Participant's financial condition resulting from adverse movements in the level or volatility of market prices. The market risks created by Contracts are exposure to changes in the price of the underlying cash instrument and changes in interest rates. There are three components to the management of market risk.~~

~~a) mark-to-market valuation~~

~~The proper market risk management derivatives begins with their valuation. Inaccurate valuation leads to incorrect income recognition and inaccurate hedging strategies. Valuation on a mark-to-market basis will reflect the current value of cash-flows and provide information about market risk and appropriate hedging actions.~~

~~b) stress simulations~~

~~Trading Participant should subject their portfolio to stress simulations. The stress simulations should~~

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~~take into account extreme market movements. The results of the stress tests should be evaluated and contingency plans developed accordingly.~~

~~c) risk limits~~

~~Trading Participant should apply a consistent measure of the market risk of their derivative portfolios and compare them regularly with the predetermined market risk limits.~~

~~(C) Liquidity risk~~

~~(1) A Trading Participant faces two types of liquidity risk in its derivatives activities:~~

~~a) Market liquidity- the risk that a Trading Participant cannot easily unwind or offset a particular position at or near the previous market price because of inadequate market depth or because of disruption in the market place.~~

~~b) Funding liquidity- the risk that the Trading Participant is unable to raise funds to meet its payment obligations on settlement date or in the event of margin calls.~~

~~(2) Because neither type of liquidity risk is necessarily unique to derivatives activities, management should evaluate these risks in the broader context of the Trading Participant's overall liquidity. In controlling liquidity risk, a Trading Participant should:~~

~~a) be able to assess its liquidity demands over a particular period; and~~

~~b) be able to assess the amount it could raise in the markets for funding and managing its exposure.~~

~~(D) Operation risk~~

~~(1) Operation risk is the risk of loss occurring as a result of inadequate systems and control, human error, or management failure.~~

~~(2) The board of directors and management should ensure there is proper dedication of resources (financial and personnel) to support operations systems development and maintenance. System support and operational capacity should be adequate to accommodate the types of derivatives activities in which the Trading Participant engages in. This includes being able to:~~

~~a) capture all relevant details of transactions~~

~~b) provide for accurate and timely input~~

~~c) identify errors~~

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~~d) efficiently process and settle all transactions accurately and in a timely manner~~

~~e) facilitate efficient reconciliation and~~

~~f) provide for proper risk exposure monitoring~~

~~(3) Segregation of operational duties, exposure reporting and risk monitoring from dealing and marketing is critical to proper internal control. Proper internal control should be provided over the entry of transactions into the database, transaction numbering, date and time notation, confirmation and settlement process.~~

~~(4) There should be a unit responsible for ensuring proper reconciliation of front and back office database on regular basis. This includes verification of position data, profit and loss figures and transaction by transaction detail.~~

~~(5) Management should ensure that a mechanism exists whereby derivatives contract documentation is confirmed, maintained and safeguarded. There should be an approved policy that specifies documentation requirements and formal procedures for safeguarding of important documents that are consistent with legal requirements and internal policies.~~

~~(6) Operations risk can be assessed through periodic reviews of procedures, documentation requirements, data processing systems and other operational practices. Such reviews may help to reduce the likelihood of errors and breakdowns in controls, improve the control of risk and the effectiveness of the limit system and prevent unsound marketing practices and the premature adoption of new products or lines of business.~~

~~(E) Legal risk~~

~~(1) Legal risk is the risk that contracts are not legally enforceable or documented correctly. Participants in the derivatives markets have experienced significant losses because they were unable to recover losses from a defaulting counterparty when a court held that the counterparty had acted outside its authority in entering into such transactions. Hence prior to engaging in derivatives transactions, a Trading Participant should:~~

~~a) adequately evaluate the enforceability of its agreements. If the governing law of the agreement is specified to be located in a third country, the Trading Participant must ensure that judgment obtained can be enforced in the Trading Participant's and counterparty's jurisdictions.~~

~~b) satisfy itself that the terms of any contract governing its derivatives activities with a counterparty are legally sound.~~

~~c) satisfy itself that its counterparties have the necessary authority to engage in the derivatives~~

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~~transactions.~~

~~d) ensure that its right with respect to any margin or collateral received from a counterparty is enforceable and exercisable.~~

~~(2) In addition to the above, a Trading Participant should have approved policies that specify documentation requirements for derivatives activities and formal procedures for saving and safeguarding important documents. The Trading Participant should have knowledge of relevant tax laws and interpretations governing the use of derivatives instruments. It should also regularly review and update its legal opinion to ascertain that the legal position of its dealing in derivatives business has not changed with regard to the enforceability of the Contract.~~

~~*[End of Appendix 1]*~~

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1. INTRODUCTION

(1) Past financial crises have shown that vast sums of money have been wiped out by bad behaviour such as unethical trading, excessive risk-taking, market manipulations, money laundering related penalties and weaknesses in internal controls. Due to this, regulation has taken on renewed importance and international regulatory standards are being reviewed and tightened.

(2) The three lines of defence model consisting of the business line managers as the first line of defence, risk control and compliance as the second line of defence while the third line of defence being the internal audit as risk assurance, are vital controls within a Trading Participant.

(3) A corporate culture with high ethical standard is a reflection of a strong compliance culture that is instilled by the Trading Participant's board of directors and senior management and practised by all levels of employees within a Trading Participant.

(4) It is imperative that sound compliance is practised to embrace the letter and spirit of the applicable laws, the Rules and Directives to ensure high standard of business conduct and ethics within a Trading Participant that will safeguard investors' interests and integrity of the market place.

(5) In light of the above, it is pertinent that the conduct of a Trading Participant's business activities be subjected to the Compliance Guidelines.

2. OBJECTIVES OF COMPLIANCE GUIDELINES

The objectives of the Compliance Guidelines are to:-

(a) provide a general guide on compliance which will serve as a basis for the formulation of the compliance manual and the measurement for the performance of the compliance function;

(b) emphasise the role, duty and responsibility of the compliance function to the CO, Trading Participant's board of directors and Trading Participant;

(c) enhance the quality and effectiveness of the compliance function;

(d) set the minimum supervisory and monitoring standard for all Trading Participants; and

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(e) provide an in-depth understanding of the duties and responsibilities of the compliance function in relation to other employees of a Trading Participant.

3. PRINCIPLES AND CONCEPT OF COMPLIANCE FUNCTION

3.1 Control function

Also termed as the middle-office function, a Compliance Officer ("**CO**") must be independent of both back and front office and ensure that the activities of both the front and back office function are carried out without any conflict of interest. A CO must have no sales and/or operational function and must not be involved in trading (e.g. he must not be allowed to solicit or execute any orders on behalf of Client), settlement, funding, processing or reconciliation activities of a Trading Participant. In this respect, the CO must only engage in full time compliance work.

3.2 Second Line of Defence

(1) The compliance function acts as the second line of defence in overseeing the various policies and control procedures that are adhered by the first line of defence, i.e. the business lines, through its day-to-day activities.

(2) Together with the internal audit, the third line of defence, the compliance function provides assurance to the board of directors and senior management on the effectiveness of the Trading Participant's overall internal controls, risk management and governance systems and processes in complying with regulatory requirements and internal policies and procedures. The internal audit department and the compliance function should strive to complement each other and work towards achieving a high standard of compliance.

3.3 Advocate Compliance Culture

A CO is responsible for creating, promoting and cultivating compliance culture and making a high standard of compliance part of the day-to-day management of the Trading Participant. A CO and heads of departments must maintain compliance by ensuring that all systems and procedures as identified by or agreed with the heads of departments that would enable heads of departments to perform their responsibilities effectively are in place.

3.4 Advisory and Supervisory Role

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A CO must advise the management, and board of directors of the Trading Participant in relation to conformity to all Securities Laws, Rules and Directives ("**Regulatory Framework**"), as well as internal policies and procedures. The CO also has a supervisory and monitoring function over all employees to ensure they carry out their duties and obligations in compliance with the Regulatory Framework and internal policies and procedures. The CO's supervisory and monitoring function does not relieve the heads of departments of their responsibilities.

3.5 Independence of Function

(1) The compliance function must be a function without any potential conflict of interest in its responsibilities and is not hindered from highlighting non-compliances of any business lines to the Trading Participant's board of directors or senior management as to achieve unflawed check and balance within a Trading Participant.

(2) In instances where the CO also assumes the duties of other control or administrative functions, the CO must ensure that the independence and ability to provide sufficient resources and commitment to the responsibilities in respect of the compliance function is not compromised and is carried out without conflict of interest, perceived or otherwise.

3.6 Overseeing Compliance and Maintenance of High Standards of Business Conduct

The CO is responsible for overseeing compliance within the organisation on a day-to-day basis and ensuring compliance with the Regulatory Framework, as well as internal policies and procedures.

3.7 Promote Proper Conduct and Segregation Of Duties

The CO must oversee the Trading Participant's policies and procedures to ensure that all back-office and front-office employees of the Trading Participant exercise proper business conduct, do not undertake any unethical practice and that their functions do not cause conflicts of interest. These policies and procedures must outline the necessary standards of personal and professional integrity expected of employees and that the Regulatory Framework is strictly adhered to by all employees of the Trading Participant.

3.8 Access to documents

A CO must have unlimited and unfettered access to all information and records in relation to the Trading Participant's business activities and must be authorised to question any employee regarding any conduct, business practice, ethical matter or any other issue which is relevant to the discharge of duties.

3.9 Liaison between the Exchange / Regulators and the Trading Participant

The CO must act as the point of reference between the Exchange, Clearing House, Commission or other regulators, where relevant, and the business lines on all compliance related matters. The CO is also to ensure that the Exchange, Clearing House, Commission or other regulators, where relevant, are supplied with documents and information as and when requested.

4. COMPLIANCE AND GOVERNANCE

4.1 Tone from the top

(1) A Trading Participant, as a whole, must be committed to the creation and maintenance of a compliance culture within its organisation. Key decisions and actions taken in regard to daily operations must be based on such a commitment, ensuring compliance with the Regulatory Framework at all times.

(2) In establishing and maintaining the compliance function, the Trading Participant, through its board of directors and senior management, must:

(a) set the compliance culture within the Trading Participant;

(b) provide necessary support to the compliance function whereby their actions must be indicative of this;

(c) ensure that employees comprehend and understand their responsibilities in respect of compliance risk; and

(d) promote an environment where employees feel safe and comfortable in reporting incidents and promoting transparency throughout the organisation through self-reporting~~.~~

4.2 Board Oversight

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(1) The compliance function of a Trading Participant is ultimately the responsibility of the Trading Participant. A strong and pro-active board of directors will foster an environment of strong internal controls and compliant procedures and practices. It will also help to inculcate compliance culture within the Trading Participant.

(2) The Trading Participant, through its board of directors, must ensure the compliance function of the Trading Participant is carried out in a holistic manner, including taking actions to:

(a) approve the organisation's compliance framework and policy and to oversee its effective implementation;

(b) approve significant policies and procedures throughout the organisation and ensure that a sound system of internal controls is maintained to safeguard shareholders' interest, company's assets and clients' interests. This covers not only financial control but also operational and compliance controls, as well as risk management;

(c) perform on-going evaluation on the effectiveness of the organisation's overall compliance risk management;

(d) appoint or ensure the appointment of a qualified person to perform the duties of a CO;

(e) appraise and deliberate on the performance of the CO; and

(f) approve the termination or acknowledge the resignation of a CO, or when the approval or acknowledgment is delegated, to ensure that the termination or resignation is for a proper reason. The Trading Participant, through its board of directors, must be informed of the outcome of the exit interviews held with a CO and ensure that actions are taken to address deficiencies, if any, that resulted in the resignation or termination of the CO.

4.3 Management Oversight

(1) The Trading Participant through its senior management in all business lines within the Trading Participant must effectively manage the compliance risk, as well as other inherent risks by developing and owning clear, comprehensive and up-to-date policies and procedures.

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(2) It is essential that the Trading Participant, through its senior management ensures that the organisational structure, reporting lines and functional responsibilities of its employees are clear, adequate and up-to-date in writing. There should be a clear segregation of duties within each department as to avoid any potential conflict of interest situation.

4.4. Qualification and Competence

Based on the above, the Trading Participant must, through its board of directors, appoint a CO with good character, business repute, qualification, experience and sufficiently broad knowledge and high level of expertise. In addition to the qualifications laid down in the Rules, the Trading Participant must, through its board of directors, ensure that the CO is equipped with the authority and ability to effect decisions and carry out responsibilities effectively. Therefore, the CO must be a person holding a **senior position** in the organisation of the Trading Participant, who can act independently and is able to fully effect decisions.

4.5 Resources

The Trading Participant must support the compliance function by employing sufficient personnel with the necessary qualifications and authority. The role and function of the CO can be best performed and executed with proper tools and mechanism as well as the support of a compliance unit to ensure the efficacy of the compliance function and programmes. The size of the compliance unit of a given Trading Participant would very much depend on the size and complexity of the business activities and operations.

4.6 Reporting to the Board of Directors or the Board Committee

The CO must report directly to the Trading Participant's board of directors or such committee appointed by the board of directors, as the case may be. In the course of his duties, the CO may bring to the attention of the executive directors or other senior management of the Trading Participant matters pertaining to compliance of the Trading Participant so as to enable appropriate action to be taken.

4.7 Ultimate Responsibility of Ensuring Compliance Within the Trading Participant

(1) The ultimate responsibility to ensure compliance with the regulatory requirements and internal control framework lies with the Trading Participant, acting though its board of directors. The CO facilitates the attainment of these objectives and does not relieve the Trading Participant of any of its responsibilities. The Trading Participant through its board of directors must undertake effective

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oversight of the formulation, coordination and implementation of any supervisory or compliance programme.

(2) Therefore, when the Trading Participant's board of directors fails to effectively supervise the overall business undertaking of the Trading Participant or the activities of its employees, including commissioned dealers, or fails to act upon a notification from the CO, the Exchange deems it a failure to act on the part of the Trading Participant. In such an event, the CO must submit a copy of the reports and recommendation pertaining to the breach of compliance and failure to act on the recommendation directly to the Exchange.

(3) Nevertheless, compliance is the responsibility of all staff within an organisation. All levels of business function must carry out their responsibilities to ensure compliance with the Regulatory Framework as well as all internal control policies and procedures set up by the Trading Participant.

5. DUTIES AND RESPONSIBILITIES OF CO

5.1 The Role of the CO in relation to the Trading Participant's Board of Directors

The CO reports directly to the board of directors of the Trading Participant or such committee appointed by the board of directors, as the case may be, and has access (when necessary) to report, update, inform and make recommendations to the board of directors or such committee appointed by the board of directors, as the case may be, on all matters pertaining to compliance and breach (or likely breach). With the Trading Participant's board of director's commitment and support in adopting the compliance principles and governance framework, a CO would be able to implement and maintain an effective compliance function that can act as a deterrent against any wrongdoing by market participants and provide the necessary foundation for the protection of investors' interests in the market.

5.2 The Role of the CO in relation to other Departments or Functions within the Trading Participant

The CO plays a supervisory role over every management level who is a supervisory head within the Trading Participant to ensure that the Trading Participant complies with all the relevant Regulatory Framework. In this respect, the CO keeps in constant communication and works closely with all supervisory heads within the Trading Participant, with a view to supplementing reviews of the supervisory heads and ensuring that the necessary policies and procedures are in place to effect proper supervision of the respective departments of the supervisory heads. In practice, this can involve the direct participation of the CO in providing legal and regulatory input to business processes or decisions. For the purposes of the Compliance Guidelines, a supervisory head means a senior officer holding a managerial position and designated to direct or supervise a particular function in a Trading Participant, who is generally a head of department but may include a manager reporting to the head of department.

5.3 Managing Compliance Risk

A CO must identify all compliance risks and implement controls into the Trading Participant's day-to-day operations to manage these risks effectively.

5.4 Managing Conflict of Interest

Conflicts of interest management is one element of a CO's day-to-day role as part of maintaining proper conduct of the Trading Participant including by reviewing policies and procedures to effect proper corporate governance and policy on "Chinese Walls".

5.5. Identify Impact of Change in Regulation and Policies

The CO must analyse the impact of any regulatory and policy changes in its business operations and communicate and disseminate such impact (if any), effectively and in a timely manner throughout the Trading Participant.

5.6 Assist in Situations of Non-Compliance or Potential Non-Compliance

Upon being notified of or identifying:

(a) an event of non-compliance; or

(b) a potential non-compliance event, including a risk of breach of rules and regulations

the CO must inform the relevant supervisor and to work with the appropriate person to rectify the matter in an efficient and practical manner, recommend remedial action to the Trading Participant and see to its successful implementation. A CO must review the course of action in the event of non-compliance, examine the extent of non-compliance and report to the Trading Participant's board of directors or such committee appointed by the board of directors, as the case may be, and the

Exchange with proposed remedies. The CO must also address audit findings raised by internal, external and regulatory auditors.

6. SUPERVISION OF THE TRADING PARTICIPANT

(1) The duty of the CO is to do everything within its powers to ensure that the Trading Participant achieves compliance with the Regulatory Framework by ensuring that there is adequate system or a set of written policies and procedures that provides for the system of monitoring in the front and back office functions. Areas of compliance in the business of a Trading Participant generally relate to Clients, operational and financial compliance.

(2) The CO undertakes an overall supervisory responsibility over the trading and operational functions of a Trading Participant. A CO monitors ongoing business activity on a pro-active basis and oversees that compliance is met by ensuring that all systems and procedures are in place and maintained by all supervisory personnel.

(3) A CO must ensure the establishment, maintenance and enforcement of an adequate supervisory and compliance system to generally supervise the overall proper running of its business activities and particularly, to supervise the activities of each Registered Representative, agent and other personnel. Such a system must be reasonably designed to achieve compliance with the applicable Regulatory Framework.

6.1 Supervisory Programme

(1) A prudent supervisory programme refers to a competent system of internal controls within a Trading Participant. Proper management controls and diligent management enhances the credibility and reputation of a Trading Participant and provides the necessary investor protection. Indeed, the supervisory and control responsibilities of a Trading Participant are crucial to the maintenance of the integrity of the marketplace.

(2) A CO must ensure the elements of a competent supervisory programme must at least consist of:

(a) Written Policies and Procedures

(i) A comprehensive documentation and written policies and procedures on the business operations are maintained and regularly updated to take into account any changes that may occur in the current Regulatory Framework. These procedures must be effectively disseminated and enforced throughout the Trading Participant. The CO must ensure that the written policies and procedures established are adequate, meet industry standards, the regulatory requirements, and the internal requirements of the Trading Participant by conducting reviews to ensure such policies and procedures meet regulatory and internal requirements and business lines have reviewed for adequacy against industry standards.

(ii) Maintenance of an internal record of all persons designated as supervisory personnel and those delegated with supervisory functions, including the dates for which such designation was effective.

(iii) Establishment of written policies and procedures of all transactions and correspondence of its Registered Representatives pertaining to the solicitation or execution of any transaction. Examples of written policies and procedures include policies and procedures on maintaining records of trading activities and trade orders from clients.

(b) Internal Review

The CO must ensure that, pursuant to the above, the relevant supervisory heads/heads of departments perform their supervisory responsibilities effectively. Regular and periodic reviews of the Trading Participant's business activities and the departments' functions must be carried out to assist in detecting and preventing violations of the Regulatory Framework. A complete written record of the details of such reviews conducted is to be maintained.

(c) Automation of Monitoring

As the complexity of a Trading Participant's business operations grow, it is recommended that automation of monitoring is employed whenever possible and practical, particularly in areas of reporting and generating exception reports.

7. SUPERVISION OF COMPLIANCE FUNCTION

(1) To be effective, the compliance function requires the formulation and implementation of tools such as compliance manual, compliance programme and checklist (collectively referred to as the

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"**Compliance Programme**"). These tools are to be tailored in accordance with the business operations of each Trading Participant.

(2) The overall objectives of a Compliance Programme are to ensure:

(a) the business activities are regularly monitored;

(b) the level of compliance of a business unit within the Trading Participant are evaluated;

(c) compliance risk and any other inherent risks are mitigated; and

(d) areas of non-compliance are rectified.

7.1 Compliance Manual

(1) A comprehensive compliance manual must be established and tailored to a Trading Participant's respective needs and reviewed for adequacy by the CO. It must elaborate on the practical applications and detailed operations of the compliance function. The manual must specify among others, the monitoring, supervisory and review procedures in relation to the compliance function.

(2) The manual must amongst others:

(a) include the outline for the compliance policies, procedures and controls of the Trading Participant to safeguard the Trading Participant and its Clients from serious risks of loss and defalcation;

(b) contain adequate procedures designated to enable the Trading Participant's business activities and the departments' functions to meet industry standards, regulatory requirements and the circumstances of the Trading Participant;

(c) contain compliance policies and procedures designed to anticipate, as far as possible, the activities most likely to result in misconduct by the Trading Participant;

(d) contain compliance policies and procedures that are monitored, enforced and effectively communicated within the Trading Participant;

(e) be subject to regular periodic review or whenever there are major changes to the Regulatory Framework; and

(f) be approved by the Trading Participant's board of directors, or such committee appointed by the board of directors, as the case may be.

7.2 Compliance Programme

A Compliance Programme documents how compliance monitoring will be performed, and will contain detailed areas of checking and state the frequency of checks that should be conducted. This is to ensure that a business process is checked to identify, assess and respond to errors and other variances that would otherwise thwart compliance with an activity's procedures. Compliance Programmes must commensurate with the size and nature of the Trading Participant and include monitoring programme over its branch offices. Compliance checks should produce accurate and timely data to measure the compliance level of a Trading Participant.

8. MONITORING BY COMPLIANCE FUNCTION

A CO must review that all areas of the Trading Participant's business and operations comply with the Regulatory Framework. The compliance monitoring programme must at least consist of the areas stated below (dependent upon the business and operational activity of the Trading Participant):

8.1 Management of Conflict of Interest

Effective management of conflict of interest involves, among others, a segregation of function, as follows:

(a) Effective handling of the Clients' trading accounts and the organisation's proprietary accounts to ensure the Trading Participant acts in the best interest of its Clients. Where such a conflict of interest does arise, to always give preference to the Client's interest. The Clients' and proprietary accounts are to be reviewed regularly within the prescribed parameters. All employees of the Trading Participant should exercise proper business conduct and do not undertake any unfair or unethical practices.

(b) There is proper segregation between functions where there are conflict of interest, including between the back-office, administration and record-keeping), the front-office trading and the risk management functions. This is to provide a necessary system of check and balances and to produce efficacy in a Trading Participant's system of internal controls.

(c) There is no concentration of authority within the supervisory ambit of one person, (e.g. the head of operations in charge of the back office must not also be supervising the dealing/trading operations) and that there is proper segregation of functions (proper corporate governance). This would prevent the abuse of position/authority and would ensure that no one person is responsible for the supervision of a large number of department/employees without any corresponding check or control.

(d) Where the Trading Participant assumes more than one role in the market place, there would inevitably be potential conflicts of interests. Hence, barriers to communication must be erected between the relevant departments of a Trading Participant to prevent the transfer and misuse of non-public information. The CO must ensure there must be adequate internal procedures pertaining to information barriers (Chinese Walls) and the strict adherence to the same, to prevent misuse of non-public information or the occurrence of other trading abuses.

8.2 Client Account Opening

That the trading accounts are approved within the provisions of the Regulatory Framework and the relevant business conduct requirements and are supported with relevant written agreement and risk disclosure statement before trading is allowed to commence. For non-face-to-face verification, ensure adequate controls are in place before accounts are accepted for approval. Adequate controls include the following:

(a) The information essential to the opening of a Client's account has been obtained, including the essential facts about the Client's financial background, investment objectives and investment experience. Any approval for the opening of the Client's account will then be based on such information as obtained.

(b) The Client's written agreement and the written approval necessary for the opening of the account has been obtained.

(c) The Trading Participant maintains at all times proper records of its Clients' accounts and to review the Trading Participant's written procedures pertaining to the opening of Client accounts.

(d) All requirements have been met prior to the approval of new Client amounts and all necessary documentation are in place, including checking that the Client's background and financial information verification is carried out.

8.3 Client Account Review

The following areas must be complied with:

(a) The procedures for account opening as well as the suitability rules have been strictly adhered to. In addition, such reviews will enable the detection of unusual patterns in trading or signs of apparent increase in the risk exposure in an account.

(b) The Client and proprietary accounts are reviewed regularly by the relevant supervisor/authorised person and to supervise such reviews.

(c) Maintain regular and periodic review of high exposure accounts or accounts of high-risk Clients.

(d) Any issues arising from any Client's account must be addressed promptly and resolved as soon as possible and where necessary, to be reported to the Exchange.

8.4 Segregation of Assets

There is a complete segregation between Clients', Registered Representatives' and Trading Participant's funds and assets.

8.5 Discretionary Accounts

Review Discretionary Accounts to ensure the following:

(a) compliance with the Rules and Directives;

(b) that prior written authorisation from the Client has been obtained;

(c) that the Trading Participant has entered into a written agreement with the Client which sets out the terms and conditions for the operation of the Client's Discretionary Account, including adequate and accurate disclosure of the risks involved;

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(d) each discretionary order must be identified as a discretionary order at the time of the entry;

(e) the trades done in a Discretionary Account are reviewed regularly;

(f) that in operating a Discretionary Account, the Trading Participant must at all times act in the best interest of the Client. In this regard, the review must include the assurance that there is a mechanism in place to prevent the churning of such accounts purely to generate commission;

(g) that all discretionary trades are executed within the proper discretionary authority granted to the Trading Participant and that such trades are properly recorded;

(h) that the maintenance of complete and accurate documentation of every transaction undertaken under any Discretionary Account; and

(i) in relation to Discretionary Account transactions, that there is no conflict of interest in the execution of Client trades and proprietary trades.

8.6 Client Complaints

The CO must:

(a) Ensure that Clients' complaints are recorded and maintained in accordance with the Rules, D~~d~~irective and internal policies and procedures. The CO must ensure that the handling of disputes are carried out in the best interest of the Clients and that a proper register is maintained to document all Clients' complaints. The register must record the following information:

(i) the identity of the complainant;

(ii) the date the complaint was received;

(iii) the Registered Representative servicing the account (where applicable);

(iv) a general description of the complaint; and

(v) the action(s) taken in respect of the complaint.

(b) Ensure that the requirements for reporting, investigating and documenting Client complaints are in place and are adhered to.

(c) Review and follow-up on the Client's Complaints Log/Register and ensure that all complaints made are duly noted and documented by a senior staff of the Trading Participant and addressed promptly.

(d) Monitor the handling of disputes with Clients' arbitrations and awards.

(e) Give immediate attention where a high number of Client complaints are received and implement mitigating strategies.

8.7 Margin

(1) There are adequate policies and procedures on margin requirements for its clients, types of margin deposits accepted by the Trading Participant as well as calling of margin and margin collection to ensure compliance with the regulatory requirements. Margin calls issued to clients are reviewed to ensure collection of margins are within the prescribed time frame. There are adequate procedures in computing undermargined charge for margin outstanding in accordance with the Rules and Directives.

(2) Also, balances with the Clearing Participant /Clearing House are monitored in transferring of margin requirement to Clearing Participant /Clearing House as prescribed in the requirements of the Clearing House rules and directives.

8.8 Position limit

There are adequate policies and procedure on setting and monitoring Client's position limits. Clients' position limits are reviewed to ensure compliance with the Exchange's imposed position limits and reportable position limits.

8.9 Collateral

The CO must ensure that appropriate collateral is received, monitored, safeguarded against loss and collateral is only released under the correct authority. The following controls over the receipt, recording and maintenance of collateral should be practised:

(a) policies and procedures on acceptance of collateral should be established before collateral is received;

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(b) review the legal documentation relating to the collateral and consider the quality, marketability of the collateral pledge and enforceability of the legal terms;

(c) clearly state the circumstances whereby collateral can be used to satisfy an outstanding Client obligation and ensure this include an event of default, liquidation or bankruptcy of the counterparty;

(d) a legal opinion should be obtained which expressly comments on the adequacy of the security arrangements contained in the underlying documentation, including a view on whether the security is well founded and off-set can be utilised;

(e) collateral once received, should be verified and details of the collateral must be recorded into the back-office system;

(f) recording of collateral must include the following:

(i) Client name;

(ii) type of collateral received;

(iii) amount (in face value terms);

(iv) quantity (number of bonds or shares);

(v) date of receipt;

(vi) date updated to back office system; and

(vii) place of safekeeping;

(g) collateral physically received for safekeeping must be placed in a secure place (e.g. fire proof vault);

(h) personnel who has no authority over the secured place of the collateral must only be allowed to gain access to the collateral with proper authorisation;

(i) collateral must be independently reconciled with third party records if such records are available;

(j) movement in the value of the collateral should be updated in the back-office system whereby shortfalls should be highlighted;

(k) procedures must be established to ensure that operations identify shortfalls and make the necessary margin calls;

(l) collateral should only be released in accordance with contract terms and on instructions from the Client and upon verification that Client's obligations have been satisfied;

(m) all release instructions must be checked against Client authorisation lists; and

(n) a final independent review must take place before collaterals are released to ensure that:

(i) all authentication procedures have been performed; and

(ii) there is sufficient documentary evidence of the instructions from the Client and to show that the Client's obligations have been satisfied.

8.10 Transactions by Directors, Employees, Registered Representatives

The CO must ensure that an employee, Registered Representative or director of aTrading Participant who trades in Contracts for his own account is subject to compliance with the provisions on conflicts of interests as set out in the Regulatory Framework and must notify the Trading Participant of such trades. The compliance function must actively monitor to ensure that proper records of all employee accounts and any transactions undertaken are maintained and that controls are in place to prevent insider trading.

8.11 Registered Representatives

The CO must ensure:

(a) Registered Representatives are properly registered with the Exchange;

(b) Registered Representatives conduct trading based on the "Know Your Customer"/Know Your Client Product" rules and do not make recommendations that are unsuitable to Clients. Such recommendations must be based on the relevant information produced by or obtained on a Client, including the Client's investment objectives and experience and his ability to evaluate the risks involved in the said recommendation;

(c) There is no conflict of interest when trading is being conducted and where such a conflict of interest does arise, to always give preference to the Client's interest;

(d) Client's instructions are always adhered to unless prohibited by the Regulatory Framework;

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(e) All transactions are properly recorded and processed;

(f) Registered Representatives do not give unpermitted incentives to Clients or prospective clients; and

(g) The record of mobility of Registered Representatives is maintained.

8.12 Marketing Representative ("MR")

(a) All MRs are properly registered with the Trading Participant.

(b) MR can only perform permitted activities as outlined in the Guidelines for Marketing Representatives.

(c) MR do not provide recommendation or advise on securities and derivatives or any other capital market products to Clients.

(d) The MR fulfils the minimum qualification and requirements as set out in the relevant guidelines.

8.13 Record-Keeping and the Supervision of Accounts

All transactions and activities must be properly recorded and documented in order to establish an audit trail. Comprehensive records of all Client accounts and transactions done must be maintained. Such records must be made readily available to persons performing supervisory functions and must facilitate the review of, among other things, the size and frequency of purchase transactions, the amount of commission generated, the profit and loss status, any undue concentration in any type of transaction, compliance with rules on margin (where applicable).

8.14 Clients' Segregated Account

(1) There must be adequate policies and procedures in ensuring reconciliation for all balances on the accounts and the operations of Clients' Segregated Account by the Account/Finance Department and controls should be put in place to ensure no co-mingling of Clients' and Trading Participant's funds/monies. There must be proper classification and disclosure of Clients' Segregated Account in accordance with the Regulatory Framework.

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(2) For any deficiencies in the segregated account, action must be taken to address the deficiencies and reporting must be conducted in a timely manner. Controls must be in place to ensure monies deposited with or received by the Trading Participant as well as withdrawal from Clients' Segregated Account is in accordance with the Regulatory Framework.

8.15 Error Accounts

Error trades must be properly recorded, processed, transferred and closed in the error account in accordance with the Rules and Directives. High frequency of error trades should warrant a review of the Trading Participant's policy.

8.16 Facilitating Account

The CO should review the usage of facilitating account to ensure it is only used when a Registered Representative is unfamiliar or uncertain of the correct Client code. It is must not be used to facilitate fast execution of trades. No Client Account is to be used as a facilitating account.

8.17 Market Maker

There are adequate system of internal controls and risk management and that the market making activities are done through the accounts designated specifically for market making (if applicable).

8.18 Adjusted Net Capital ("ANC")

The CO must ensure that the requirements on the maintenance of minimum ANC of the Trading Participant at all times and the adjusted net capital report is reviewed prior to submission to the Exchange in accordance with the provisions prescribed in the Rules and Directives.

8.19 Maintenance of Paid-up Capital

The CO must ensure compliance with the requirements on the maintenance of the minimum paid-up capital of the Trading Participant as prescribed in the Regulatory Framework.

8.20 Accounting / Financial Review

(1) The CO must ensure there are adequate policies and procedures to ensure accounting information are complete, accurate and processed on a timely basis where accounting related reconciliation must

be performed by an independent officer and on a periodic basis. Reconciliation differences must be investigated and promptly resolved.

(2) A proper accounting system must be implemented to ensure existence of an audit trail and provide accountability to the accounting data captured in the system. Accurate and prompt recording of cash receipt/disbursement must be put in place to monitor cash balances maintained at adequate levels.

(3) Proper classification and disclosure must be implemented in accordance with the reporting guide of the Regulatory Framework and submission of regulatory reporting must be made in an accurate and timely manner as prescribed in the Regulatory Framework.

8.21 Contract-For-Difference (“CFD”)

There must be adequate policies and procedures in place to monitor CFD trades and to ensure all relevant reporting are made in accordance with the requirements in the Rules and Directives.

8.22 Market Surveillance Monitoring

There must be adequate policies and procedures in place to monitor the strict adherence to provisions on market surveillance monitoring as contained in the Regulatory Framework, including the parameters used that would enable detection of possible market manipulation. The CO must ensure adequate records are being retained for the monitoring, escalation and reporting of alerts.

8.23 New Product / Activity

For any new activity/product undertaken by the Trading Participant, adequate assessments have been undertaken by the Trading Participant prior to the commencement of the new product/activity to be in compliance with the Regulatory Framework.

8.24 Advertisements, Sales Literature and Other Forms of Communications to Client / Public

Promotional materials or other forms of communication issued by a Trading Participant must be in line with the Regulatory Framework, including the Commission’s Guidelines on Advertising for Capital Market Products and Related Services. It must be factual, accurate, avoid misrepresentation, not misleading, make no promise in respect of profits and must always indicate the possibility of loss if profit is mentioned. Special care must be taken where forecasts or projections are included. Such information must be clearly identified as such and all underlying assumptions, risks and cost must be clearly stated.

8.25 Cybersecurity

Adequate measures must be put in place to protect the Trading Participant from possible cyber-attacks.

9. EFFECTIVE COMMUNICATION

Effective communication channel must exist between the CO and the Trading Participant's board of directors and employees. This is vital in ensuring information in relation to the Regulatory Framework and internal policies and procedures are relayed and implemented efficiently and effectively.

9.1 Dissemination of information

Information or notification pertaining to the Regulatory Framework and internal policies and procedures to the Trading Participant's board of directors, senior management and employees, must be relayed via effective means of communication. The CO is to ensure that all notifications from the Exchange and the Commission are properly disseminated to the relevant employees within the Trading Participant.

9.2 Access to CO

The CO is to keep constant communication with all business lines stakeholders within the organisation with the aim of both the CO and employees having direct access to each other. It would also complement proper supervision of the existing policies and procedures and to tackle any identified gaps.

9.3 Communication on Outcome of Monitoring

Clear policies and procedure on communication between the CO and the employees and vice versa on matters of non-compliance must be established. All employees should be made aware that non-compliances are to be communicated and acted upon immediately.

10 ESCALATION, REPORTING AND CONSEQUENCE MANAGEMENT

10.1 Documented Process

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In ensuring compliance with the obligation to notify the Exchange of non-compliance matters, the CO must ensure that there is a clear, well-understood and documented process for:

(a) identifying indicators of reportable matters;

(b) ensuring that employees escalate potentially reportable matters to the CO, who are made aware of the indicators identified;

(c) determining whether indicators of reportable matters give rise to an obligation to report; and

(d) notifying the Exchange in writing of reportable matters.

10.2 Escalation

(1) Escalation is the process of alerting or notifying the higher level of management of a non-compliance issue or a potential non-compliance issue by an employee when he or she becomes aware of the same. A formalised escalation procedure sets a clear reporting flow in the case of a non-compliance issue or a potential non-compliance issue and would facilitate in managing and resolving such issues in an efficient and practical manner.

(2) It is important that the relevant employees of a Trading Participant are made aware of compliance matters that are required to be escalated. A clear escalation procedure would enable employees of a Trading Participant to direct non-compliances to the correct personnel for an expedited resolution.

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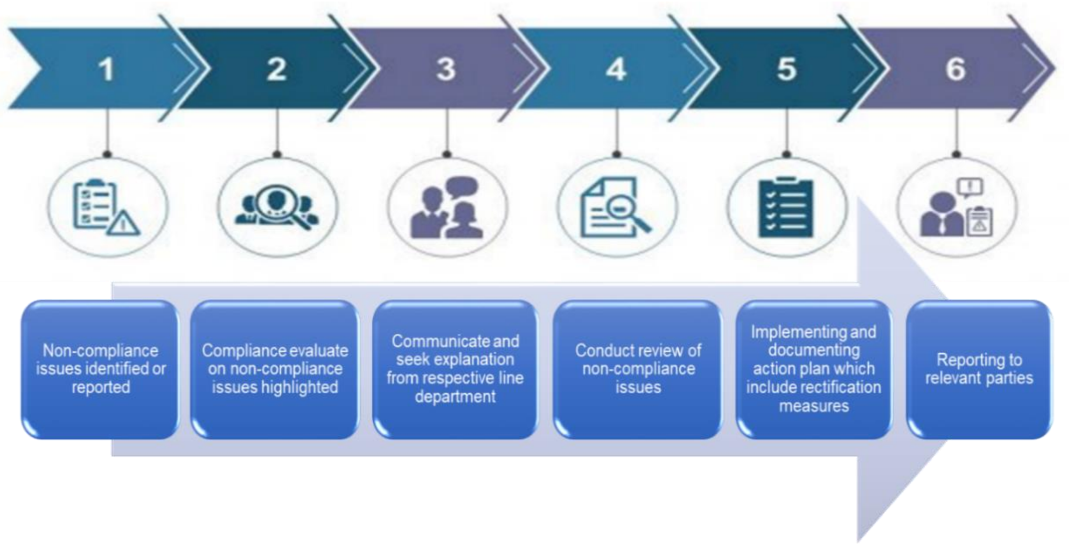

10.3 Reporting on Compliance Matters

A CO must bring matters pertaining to compliance to the attention of any of the board of directors, heads or other senior management of the Trading Participant on a timely basis for appropriate action to be taken.

10.4 Consequence Management on Breaches

(1) Consequence management refers to action taken to address non-compliances by a Trading Participant to comply with the obligations under the Regulatory Framework.

(2) Trading Participants must have a well-formulated consequence management procedures with a clear, well-understood and documented process for identifying and dealing with breaches such as:

(a) measures on how to identify a breach;

(b) ensuring that the breach is escalated to the relevant supervisor;

(c) determining the degree of the breach, e.g., minor or significant;

(d) taking immediate rectification measures to the breach;

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(e) reporting of the breach to the Exchange, together with rectification measures / plan;

(f) ensuring that arrangements are in place to prevent the recurrence of the breach;

(g) dealing with the consequences of breaches, particularly to clients, comprehensively (e.g. by communication and / or compensation); and

(h) communicating breach to the relevant staff of the Trading Participant to deter recurrence (“Lesson Sharing”).

(3) Consequence management will allow employees to further identify the possible non-compliance issues and take proactive measures in ensuring compliance.

11. CONTINUOUS TRAINING AND UPDATES ON REGULATORY DEVELOPMENTS

11.1 Training for Compliance Function

Apart from programmes and training, the compliance function must keep up with the developments in the regulatory requirements by undertaking constant review of relevant updates of the Regulatory Framework.

11.2 Training and Education Programmes for Employees of Trading Participant

(1) The CO must ensure that adequate and timely training is provided to employees of a Trading Participant on relevant regulatory requirements governing its activities and to be able to provide guidance on the implementation of internal controls to manage compliance risk.

(2) Training and other support should focus particularly, but not exclusively on:

(a) The Regulatory Framework and any other supervisory and regulatory requirements that may be relevant; and

(b) The internal policies and procedures of the Trading Participant and its organisational reporting structure in the area of the regulated activity.

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12. CONCLUSION

A constructive and cooperative working relationship between the compliance function and business lines can improve the overall identification and management of compliance risk. The adoption of the approaches set out above will result in a high level of confidence amongst all stakeholders that regulatory objectives are being met. These positive regulatory outcomes would lead to a stable and sustainable business operations for a Trading Participant.

[End of Appendix]