

PN-ACC-004

**Approaches to Derivatives Market  
Regulation for Financial Safety and  
Fairness by Various Jurisdictions**

**Financial Institutions Reforms and  
Expansion (FIRE) Project**

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**December 23, 1997**

**Financial Institutions Reform and Expansion (FIRE) Project  
US Agency for International Development (USAID/India)**

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# *Price Waterhouse LLP*



December 23, 1997

Mr. O. P. Gehrotra  
Securities and Exchange Board of India  
Mittal Court, Nariman Point  
Mumbai 400 021

Dear Mr. Gehrotra,

**Re: Approaches to Derivatives Market Regulations**

At your request and as part of our contract with USAID, Ms. Kate Hathaway, Chief of staff Commodity Futures TRADING Commission of US, Washington D.C. and a consultant to Price Waterhouse Capital Markets (PW), has completed a report as part of our activity towards assisting the SEBI Derivatives effort.

This report contains a description of approaches to the regulation of derivatives markets by seven jurisdictions; five of which deal with screen-based trading systems. The jurisdictions are United States of America, United Kingdom, Hong Kong, New Zealand, Sweden, Germany and Malaysia.

The report primarily addresses the regulatory approaches to following areas:

- Net Capital Rule
- Customer Funds Segregation
- Margin Collection from Constituents
- Standards of Permitted Collateral for Deposit/Margin
- Broker Qualification and Registration
- Sales Representations and Disclosure
- Recordkeeping Requirements

The report is not intended to give a complete set of regulations in the areas mentioned above but to provide an overview of regulatory responses to these issues relating to derivatives instruments. The objectives is to provide both the Securities and Exchange Board of India (SEBI) and the National Stock Exchange of India Limited (NSE) with a point of regulatory reference in these key areas as both entities prepare regulations and commerce regulating a derivatives market.

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Rules pertaining to these regulatory issues are crucial to two major regulatory goals: financial safety and fairness. Furthermore, these are the regulatory areas that have been highlighted to both the NSE and SEBI. National Stock Exchange of India Limited (NSE) and / or Securities and Exchange Board of India (SEBI) should ensure that, for purpose of determining financial adequacy, all of the brokerage house's accounts and positions, regardless of the exchange or market on which they took place are aggregated into one general ledger, and made part of one trial balance and one net capital computation.

In addition the surveillance program should include procedures for assessing adverse trends in the financial condition of members and assessment of the markets which could affect the condition of and pose potential financial risks to its members. This includes daily analysis of the effect of market price movements on firm capital, review of clearing house pay and collect data and intensified surveillance of firms considered high risk (such as daily calls for segregation and net capital data). Ongoing surveillance should include thorough reviews of all financial reports filed by member-FCMs and member-IBs and any follow-up work required as a result of the review.

Please get in touch with us at the FIRE Project for any clarifications you may require.

Thanking you,

Yours sincerely,

*W. Dennis Grubb*

**W. Dennis Grubb**  
**Principal Consultant**

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## I EXECUTIVE SUMMARY

This report contains a description of approaches to the regulation of derivatives markets by seven jurisdictions; five of which deal with screen-based trading systems. The jurisdictions are United States of America, United Kingdom, Hong Kong, New Zealand, Sweden, Germany and Malaysia<sup>1</sup>.

The report primarily addresses the regulatory approaches<sup>2</sup> to following areas:

- Net Capital Rule
- Customer Funds Segregation
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The report is not intended to give a complete set of regulations in the areas mentioned above but to provide an overview of regulatory responses to these issues relating to derivatives instruments. The objective is to provide both the Securities and Exchange Board of India (SEBI) and the National Stock Exchange of India Limited (NSE) with a point of regulatory reference in these key areas as both entities prepare regulations and commence regulating a derivatives market.

Rules pertaining to these regulatory issues are crucial to two major regulatory goals: financial safety and fairness. Furthermore, these are the regulatory areas that have been highlighted to both the NSE and SEBI.

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<sup>1</sup> Hong Kong, New Zealand, Sweden, Germany and Malaysia have screen-based trading systems.

<sup>2</sup> The International Organisation of Securities Commissions (IOSC), International Regulation of Derivatives Markets, Products and Financial Intermediaries Common Framework of Analysis and Cross Regulatory Summary Chart, 1996 Edition.

## II NET CAPITAL RULE

For purposes of protecting market integrity and viability, in addition to protection of the exchange and its clearinghouse, exposure to constituents and other creditors must also be addressed. This is ordinarily accomplished by establishing a "Net Capital Rule" providing standards for minimum capitalisation and liquidity, and maximum leverage. Members must be in continuous compliance with such rule, and to document such compliance at least monthly with a trial balance and computation of net capital. Reports should be made to the appropriate regulatory agency on a regular basis (non-audited reports at the end of each quarter and an audited report at the end of the fiscal year). Such reports should be on timely basis (within three weeks of the quarter end, and within two months of the fiscal year-end).

National Stock Exchange of India Limited (NSE) and/or Securities Exchange Board of India (SEBI) should ensure that, for purpose of determining financial adequacy, all of the brokerage house's accounts and positions, regardless of the exchange or market on which that took place, are aggregated into one general ledger, and made part of one trial balance and one net capital computation.

### How do other jurisdictions implement Capital Adequacy Standards?

#### A. United States of America

##### 1. *Commodities Futures Trading Commission (CFTC)*

CFTC Rule 1.17 prescribes the minimum levels of "adjusted net capital" which Futures Commission Merchants (FCMs) and Introducing Brokers (IBs) must maintain. Adjusted net capital equals "net capital" (current assets minus liabilities) minus various charges or adjustments such as under-margined accounts of customers, charges for exchange options granted by the FCM's customers, and uncovered futures positions and exchange options granted in the house account of the FCM. In addition, certain deductions known as "haircuts" must be made from the value of securities and various other obligations carried as assets of the FCM or IB.

Rule 1.52 requires each Self Regulatory Organisation (SRO) to adopt and submit for CFTC approval, rules prescribing minimum financial and related reporting requirements for all its FCM members. The National Futures Association (NFA) is also obligated to adopt such rules for its IB members, while exchanges are so obligated only if they elect to have a category of membership for IBs. The financial and related requirements adopted by the SROs must be equal to, or more stringent than, the CFTC's minimum levels.

CFTC Rule 1.12 establishes an "early warning system" under which firms are required to notify the CFTC of certain adverse changes in the firm's financial condition so that remedial action may be taken to protect customers and the marketplace from potential injury.

For purposes of overall risk assessment, the CFTC is authorised to obtain information from FCMs regarding the activities of their non-CFTC registered affiliates that are reasonably likely to have a material impact on the FCMs' financial or operational condition. The CFTC issued final rules to ensure that all FCMs report reductions in net capital. Additionally, the rules require reporting of a margin call that exceeds an FCM's excess adjusted net capital which remains unanswered on the next business day and requires reporting by an FCM whenever its excess adjusted net capital is less than six percent of the maintenance margin required to support non-customer positions carried by the FCM.

Clearing houses, however, require their members to maintain a minimum level of capital in order to ensure that clearing members will be able to meet their obligations to the clearing house and to their customers. Clearing houses also require their members to make substantial deposits to a clearing house guaranty fund to cover any default made by that member, and if necessary, to cover the default of another member.

Enforcement of these rules is done through a program of CFTC oversight of SRO financial surveillance programs.

The surveillance program should include procedures for assessing adverse trends in the financial condition of members and assessment of the markets which could affect the condition of and pose potential financial risks to its members. This includes daily analysis of the effect of market price movements on firm capital, review of clearing house pay and collect data and intensified surveillance of firms considered high risk (such as daily calls for segregation and net capital data). Ongoing surveillance should include thorough reviews of all financial reports filed by member-FCMs and member-IBs and any follow-up work required as a result of the review.

The CFTC issued final risk assessment rules concerning the maintenance and filing of organisational charts, risk assessment policies procedures and systems, consolidated and consolidating financial statements and trigger events relating to events occurring at the FCM.

## **2. *Securities and Exchange Commission (SEC)***

The SEC requires registered broker-dealers to have and maintain specified amounts of net capital. Net capital is a defined term. It is, in essence, the net worth of a broker-dealer reduced by prescribed percentages of the market value of securities owned by the broker-dealer and by other assets not readily convertible into cash.

Pursuant to Option Clearing Corporation (OCC) rules approved by the SEC, OCC clearing members must generally maintain initial net capital equal to at least \$1,000,000 for a period of up to one year and thereafter must maintain minimum net capital equal to at least \$750,000. OCC clearing members who carry options positions for other firms generally maintain higher levels of net capital.

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Compliance with the financial responsibility rules is monitored through the SEC's FOCUS reporting system which consists of monthly, quarterly, and annual financial reports; the annual report is audited. The Commission's regulatory scheme is an oversight structure.

OCC requires each member to file an annual audited financial report and monthly unaudited financial reports and to notify OCC if certain financial parameters are broken. OCC performs financial surveillance activities designed to identify clearing members whose financial or operational condition has been deteriorating and identify options related positions that pose unwarranted levels of risk to the clearing member and OCC. Based upon the information gathered, OCC may require more frequent reporting, higher margin levels or some other action by the clearing member.

The Commission, in its oversight role, performs periodic inspections of OCC. In addition, OCC engages outside auditors to perform a yearly audit of its financial condition and system of internal accounting control, for the period since the last report, the results of which OCC files with the Commission and makes available to its members.

## **B. United Kingdom**

### The Securities and Investment Board (SIB)/ The Securities and Futures Authority Limited (SFA)

In the UK, clearing firm means a firm which accepts primary responsibility (including legal liability) for the settlement of transactions for counterparties. These firms must maintain, at all times, liquid capital equal to or in excess of a specified minimum: the sum of the firm's base requirement plus any investment position risk requirement (PRR) including foreign currency and counterparty risk requirement (CRR).

The base requirement is primarily aimed at ensuring that firms have sufficient liquid capital to enable them to sustain a period of reduced (or possibly nil) revenue. The PRR is designed to ensure that the firm has sufficient capital to support its proprietary positions, that is to provide for the economic risk of potentially adverse price or interest rate movements. The CRR is designed to cover the risk that some customers or counterparties may not perform or fulfil their contractual obligations or may not complete their side of a transaction.

The starting point for computing the firm's available financial resources in the firm's "Tangible Net Worth." From this the firm is required to make deductions in respect of certain illiquid assets, either in full or in part. These include: fixed assets; physical stock not associated with the firm's investment business; investments in connected companies; prepayments and cash deposits which cannot be withdrawn within 90 days.

Those firms which are not clearing firms (*i.e.*, firms which do not carry or clear customer accounts, and which have entered into arrangements with a clearing firm for

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that purpose, for example, introducing brokers) are subject to capital-based requirements which are calculated in a similar way to those for clearing members.

For higher risk firms which do not carry and clear customer business of other firms the calculation is the same as for clearing members, except the "absolute minimum" is £ 10,000.

Clearing firms are required to submit monthly financial returns to SIB (or the relevant SRO), non-clearing firms submit financial returns on a quarterly basis. All firms submit annual audited reports. The information is analysed and trends or unusual items are identified; if there is concern, a visit to the firm will be undertaken. Firms also provide information regarding commission/equity ratios and the amount of segregated funds which are held. This information is gathered for purposes of, *inter alia*, identifying indications of churning or other improprieties.

The frequency with which periodic audits of firms are undertaken is at the discretion of the organisation granting authorisation, i.e., either SIB or the relevant SRO. In practice, firms will generally be subject to routine annual visits and may be subject to additional spot checks.

### C. Hong Kong

#### Securities and Futures Commission (SFC)

The HKFE Clearing Corporation Limited (HKCC) has two types of clearing memberships: General Clearing Members (GCM) and Clearing Members (CM). A GCM is permitted to clear transactions for its own account and the accounts of non-clearing Hong Kong Futures Exchange Ltd. (HKFE) members. A CM generally is permitted to clear trades only for its own account. HKCC imposes minimum capital requirements of HKD 25 million for GCMs and HKD 2 million to HKD 5 million for CMs. HKCC also bases membership on the knowledge and financial integrity of the individuals or principals behind the proposed clearing firm..

HKFE members are also required to maintain a debt-to-equity ratio of 2:1 or less and at least required minimum Adjusted Net Admissible Assets. Finally, HKCC imposes position limits on members in relation to their capital.

In regards to the Stock Exchange of Hong Kong Ltd (SEHK) listed stock options contracts, the Stock Exchange of Hong Kong Options Clearing House Ltd. (SEOCH) member must have liquid capital the greater of five percent of its total liabilities or HKD 20 million if a GCM, HKD 5 million if a Direct Clearing Member or HKD 3 million if a Self Clearing Member.

Under the SFC's Financial Resources Rules, securities dealers are subject to a liquid capital requirement which is a minimum of HK \$3,000,000 (approx. US \$387,000) for corporations and HK \$500,000 (approx. US \$64,500) for sole proprietors. After a certain level of activity has been reached the liquid capital requirement will vary with the level of business undertaken and is set at five percent of liabilities.

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SEHK and HKFE Compliance Departments determine whether firms are in compliance by conducting a series of on-site audits of members on a routine basis. SEHK and HKFE rules also permit their respective Compliance Departments to conduct surprise audits. Both systems employ on-line updates on an intra-day basis to members' positions and risk exposures. SECH and HKCC and their own surveillance staff, but rely primarily on the Compliance Departments of the exchanges.

HKFE and SEHK rules require all members to submit audited annual accounts and monthly financial returns. Annual accounts must be accompanied by the auditors' declarations that the members concerned have complied with the SFC's financial resources rules. HKFE and SEHK conduct routine on-site inspections of their members and visit each member approximately once every two years. In addition, the SFC inspects approximately five percent of HKFE and SEHK members each year.

Non-exchange member dealers must file annual audited accounts and quarterly financial returns with the SFC. The SFC inspects each such dealer approximately once every three years.

#### **D. New Zealand**

##### New Zealand Securities Commission (NZSC)

New Zealand Futures & Options Exchange (NZFOE) requires each Exchange Broker to ensure that at all times its financial resources exceed its Financial Resources Requirements, the latter comprising its Base Requirement plus its Volume of Client Business Requirement and its Investment Position Risk Requirement as applicable.

#### **E. Sweden**

##### The Financial Supervisory Authority (FSA)

An exchange being a company shall possess an equity capital which is sufficient regarding to the kind and scope of its business. At the assessment of the size of this capital there shall as well be included other financial resources disposable to the exchange.

A clearing organisation shall have such a capital, guarantee, insurance or other financial arrangement that customers will get a satisfactory protection against possible losses caused by clearing. This means that the capital requirement ought to be measured out of the risks of the clearing activities, *e.g.*, contract responsibilities and payment claims.

## **F Germany**

### Bundesaufsichtsamt für den Wertpapierhandel (BAWe)

Capital, authorisation and good standing requirements for Clearing Members and the Deutsche Terminbörse (DTB)'s clearing facility, are established by the "Clearing Conditions for Trading at the Deutsche Terminbörse". Specifically, General Clearing Members (GCMs) which also represent Non-Clearing Members (NCMs) must provide evidence that they have available capital within the meaning of Section 10 of the Banking Act of at least DM 250 million, and Direct Clearing Members (DCMs) of at least DM 25 million.

Pursuant to Section 7(4)3 of the Exchange Act, Exchange Participants which are not credit institutions have to provide collateral to an amount not exceeding DM 500,000 (no pure intermediary business can be transacted on the DTB or in options trading on the Frankfurt Stock Exchange; the maximum collateral to be provided by brokers purely acting as intermediaries is DM 100,000).. Collateral has to be provided in the form of a credit institution's guarantee or a suretyship insurance policy.

Under the Banking Act, any credit institution conducting deposit and lending business must have at its disposal the equivalent of at least ECU 5 million of paid-up capital, amounts paid up on members' shares or reserves less "preferential shares".

For financial intermediaries which are neither credit institutions nor participate in trading on the Exchange, there are no such requirements at present. This will change, however, with the implementation of the European Community Capital Adequacy Directive (CAD).

## **G Malaysia**

### Securities Commission (SC)

There are no statutory provision in the Futures Industry Act 1993 (FIA) in respect to capital-based qualifications. However, the Exchange is required to maintain to the satisfaction of the Minister of Finance an adequate and properly equipped place of business and facilities. Nor are there any specific capital requirements in respect to the clearing house. However, the clearing house is required to have adequate capital and suitable systems, procedures and arrangements in place to manage the risks, liabilities and obligations with respect to futures contracts cleared by it.

In relation to Malaysian Derivatives Clearing House (MDCH), pursuant to its business rules, the clearing members must have minimum net tangible assets of MYR

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3 million, minimum adjusted net capital of the higher of MYR 0.5 million or 10% of total margin obligations. The clearing members are also required to lodge a security deposit of MYR 1 million with MDCH.

In relation to Malaysian Futures Clearing Corporation (MFCC), its clearing members must maintain a paid-up share capital of not less than MYR 1 million and maintain net tangible assets of not less than MYR 2 million. The clearing members are also required to maintain a security deposit of MYR 500,000 lodged with MFCC. Clearing members who are brokers must also observe the adjusted net capital requirement of the higher of MYR 0.5 million or 5% of their clients segregated funds.

Other financial intermediaries that are not members of the clearing house will have to maintain capital requirements as imposed by their respective exchanges. In relation to Malaysia Monetary Exchange (MME), a broker member must be a clearing member. A non-broker member who is not a clearing member must have a paid up capital of MYR 2 million, net tangible assets of MYR 3 million and the same adjusted net capital as for broker members. Individual members (locals) require a risk capital of at least MYR 30,000.

In relation to Kuala Lumpur Options and Financial Futures Exchange (KLOFFE), a non-clearing trading member is required to have a minimum paid up capital of MYR 5 million, and must conform to such other requirements as specified under the FIA. Local members must meet the capital requirements as set by the exchange.

In relation to Kuala Lumpur Commodity Exchange (KLCE), a non-clearing broker member is required to maintain a minimum paid up capital of MYR 500,000 and net tangible assets of not less than MYR 500,000. In addition, they are also required to maintain an adjusted net capital of MYR 250,000 or five percent of the clients segregated funds whichever is higher.

### III PROPER SEGREGATION OF CUSTOMER FUNDS

In addition to segregation of customer funds in bank account separate from firm funds, SEBI and the Ministry of Finance should pursue with the Reserve Bank of India Bank compliance with segregation of customer/constituent funds. Both the Central Bank and SEBI should promulgate rules that require the member to have a contract or agreement with the bank, in a form acceptable to the exchange (or SEBI) providing that the bank has been advised by the member that all funds deposited in the account are being held by the bank for the exclusive benefit of customers/constituents of the member in accordance with this rule, that these funds shall be subject to no right, charge, security interest, lien or claim of any kind in favour of the bank. Such account could be titled "Special Account for the Exclusive Benefit of Customers/Constituents of (Member's Name)."

The member shall be required to maintain records documenting all financial transactions with and for customers/constituents, evidencing that such transactions were properly conducted through this Special Account. Furthermore, trading members should not be able to use the funds of one constituent to purchase, margin, secure, or extend credit to persons other than that constituent.

#### How do other jurisdictions implement Segregation of Customer Funds?

##### A. United States of America

###### I. CFTC

Commodity Exchange Act (CEA) states that an FCM and clearing organisation must separately account for customer funds on their books and records, and segregate such customer funds from their own funds and funds of other persons. However, an FCM may pool all customer funds in a single account which must be clearly identified as belonging to customers.

When customer funds are deposited in a bank, trust company, clearing organisations or another FCM, rules require that the funds be deposited under an account name that identifies the account as containing segregated customer funds. Those provisions also require that the depository organisation sign an acknowledgement that it was informed that the funds deposited therein are held in accordance with the CEA and regulations thereunder. The FCM and clearing organisation must obtain and retain in its files each such acknowledgement. The effect of the acknowledgement is that when the funds are deposited in a bank, for example, the bank cannot exercise its traditional right of setoff against those funds for the obligations of the FCM or any other person nor can it recognise the assertion of any claim, lien, or security interest against the customer funds for obligations of other persons.

Rule provides that an FCM may not use the funds of one customer to purchase, margin, secure or extend the credit of any person other than that customer.

To be in compliance with the segregation requirement, an FCM must always have in segregation, free from claims, sufficient money to completely liquidate all commodity accounts which would have equities if the accounts were closed out at the market price at any point in time.

Regulations permit FCMs and clearing organisations to invest customer funds in obligations of the U.S., general obligations of any State or of any political subdivision thereof, and obligations fully guaranteed as to principal and interest (*i.e.*, backed by full faith and credit) by the U.S.

FCMs or clearing organisations that invest customer funds must keep a record showing, among other things, the date on which investments were made and liquidated or otherwise disposed of and the amount thereof, the identity of the depositories or other places where such obligations are segregated, and the names of the persons through whom the investments were made or liquidated.

### 3. SEC

Rule 15c3-3 covers customer funds, and requires the broker-dealer to make a periodic computation (in accordance with a formula) to determine how much money it is holding which is either customer money or money obtained from the use of customer securities ("credits"). From that the broker-dealer subtracts the amount of money which it is owed by customers or by other broker-dealers relating to customer transactions ("debits"). If the credits exceed the debits, the broker-dealer must deposit the excess in a Special Reserve Bank Account. If the debits exceed the credits, no deposit is necessary.

#### B. United Kingdom: SIB/SFA

The purpose of the Client Money Regulations (CMRs) is to ensure that in the event of the insolvency of a firm, client money is protected from the claims of general creditors and from any right of set-off by the depository where the money is held. To this end, an express statutory trust has been imposed on the funds covered by the regulations (CMR 3.02), and depositories are required to acknowledge to the firm that they have no right of set-off over client money (CMR 2.06). "Client Money" is defined in CMR 2.01 as money of any currency which, in the course of carrying on investment business, a firm holds in respect of any investment agreement entered into, or to be entered into, with or for a client.

In relation to the on-exchange transactions, the firm must ensure that on each business day the total of:

- balance held in the firm's on-exchange client bank account; and
- the net aggregate of the firm's equity balance in relation to those segregated customers with exchanges, clearing houses and intermediate brokers; and
- the current value of approved collateral deposited with the firm;

is not less than the aggregate of:

- 
- the amount of the segregated customers' initial requirement;
  - the aggregate of the equity balance of segregated clients; and
  - the value of the approved collateral deposited by those clients with the firm.

4 In the event that the segregation requirement is not satisfied, a firm must use its own funds to "top up" any shortfall.

Interest is generally payable to the client on the money held for him, at a fixed rate. However no interest need be paid:

- where the amount of money held is less than £ 10,000 and is held for less than 10 business days;
- on monies properly held in margined transaction, settlement or dividend claims accounts; or
- where the firm has agreed (in writing) with the client that it will not pay interest.

### C. Hong Kong: SFC

Dealers must deposit clients' monies (less brokerage and other proper charges relating to the requirements of a clearing house) within four days after receipt into segregated accounts kept with registered deposit-taking companies or licensed banks. Such monies in segregated accounts shall not be available for payment of debts of dealers or be liable to be paid or taken in execution under the order or process of any court, with the exception of certain specified claims and liens. HKFE's and SEHK's rules require members to deposit client monies into segregated accounts within two days after receipt.

### D. New Zealand: NZSC

Pursuant to Section 41(1) of the Securities Amendment Act 1988, The Futures Industry (Client Funds) Regulations of 1990 provide for the establishment and maintenance of client bank accounts and client funds accounts by dealers in futures and options contracts. These regulations require client money to be paid into or credited to client bank accounts and restrict the disbursements of client money from client bank accounts and the debiting of amounts to client funds accounts. They prescribe requirements relating to the deposit of client property in safe custody, restrict the availability of client money and client property to meet liabilities of the dealer or other persons and give further protection to client money and client property in cases where the dealer is insolvent.

### E. Sweden: FSA

Customer funds deposited at securities firms are to be separated from the own funds of the firms. In consequence to the new legislation, these firms have to apply for a special license in case of their aiming at capital management and not only depositing of customer's funds.

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**F. Germany: BAWe**

Customer funds and positions must be accounted for separately from the proprietary funds of a credit institution. The customer retains title to the securities pledged as collateral. A bank must keep the securities of its customers physically separate from its own holdings. If such securities are held with a central depository bank in collective safe custody, the customers' securities will be accounted for in the books of the bank separately from the bank's own holdings.

**G. Malaysia: SC**

The FIA requires that all futures brokers to segregate funds or property that belong to a client from other property of the broker. Futures brokers are required to initially place client funds received into a client's segregated account. The aim of segregation is to ease identification of clients' funds, facilitate the transfer of clients' positions by the clearing house in the event of insolvency of a broker, and to protect funds claims of creditors of an insolvent broker.

A futures broker is also required to keep separate accounting records with respect to their segregated account, which separately records the deposits and withdrawals with respect to each client. Again, separate records must be kept with respect to property in safe custody. Segregated money or property is not available to pay the general creditors of a broker on liquidation or bankruptcy.

## IV COMPULSORY MARGIN COLLECTION FROM CONSTITUENTS

Requirements for issuing and collecting initial as well as maintenance margin should be understood by both brokers and customers. Procedures should be in place to ensure that initial margin has been received from the constituent prior to establishing any opening position in a stock index futures contract. It should be clear that the member should be REQUIRED to collect at least the amount of margin which is required to be deposited on behalf of the client. The member should have the RIGHT to demand ADDITIONAL margin above these minimum levels as he should so require. Also in case where the constituents fails to timely meet margin calls (two days), market orders to close out positions should be entered immediately.

### How do other jurisdictions implement margin collection from constituents?

#### A. United States of America

##### 1. CFTC

FCMs collect "initial" margin from their customers. The initial margin is the exchange set minimum margin requirement for the contract. FCMs are free to impose higher customer margin requirements and, subject to exchange minimum requirements, may vary margin. When losses in a customer's account reduce margin below maintenance margin levels set by the FCM, the FCM will issue a "margin call" to the customer requiring the customer to deposit funds sufficient to restore margin on deposit with the FCM to 100% of the initial margin requirement. The FCM does not pay capital charges for margin deficiencies for 3 days; customer deficits, however, must be covered by the FCM the same day for segregation compliance.

##### 2. SEC

Purchasers of index options must provide initial margin equal to 100% of the option's current market value (premium). The options SROs calculate margin requirements for each short put or call using a formula that requires initial and maintenance margin for short options positions equal to 100 percent of the option's premium plus a fixed percentage of the underlying product's value. The options SROs' rules provide for margin level reductions for out-of-the-money options. Broker-dealers may require higher margin payments than established by the options SROs.

OCC requires margin equal to the current market price of a short option plus a cushion to protect from the risk of a change in the current market price. Both also provide for offset of unsegregated long and short options within the same series. Among other things, both margin systems use options pricing theory to project the cost of liquidating a member's portfolio of positions in the event of an assumed "worst-case" change in the price of the underlying asset or index.

OCC can also issue intra-day margin calls for additional margin deposits. An intra-day margin call is made to protect OCC against extreme intra-day market

Broker-dealers collect margin for stock index options positions from their customers on a gross basis. OCC collects margin for stock index options positions from their clearing members on a gross basis for customer accounts and on a net basis for firm and market-maker accounts.

OCC calculates required margin for each member on a daily basis and collects additional margin only when a deficit exists. Within each member's accounts, OCC totals margin for each position (or net amounts for spread positions) into one single figure, which is added to any amounts for premium and settlement payments to arrive at one amount for payment or receipt the next morning.

**B. United Kingdom: SIB/SFA**

If at the close of business on any day, the amount of a customer's initial margin requirement at that time exceeds the aggregate of that customer's equity balance at that time and the amount of the value of that customer's approved collateral at that time held by the firm or an intermediate broker or an exchange, the firm shall require the customer to deposit with the firm, not later than the close of business on the next following business day, an amount in cash or approved collateral to a value not less than the amount of the excess. A firm may close out a customer position if these requirements are not met and, generally, must close out after five days. The applicable amount of initial margin must be not less than the initial margin requirement imposed by the relevant exchange; in practice, the firm generally collects a greater amount. The firm may, in certain circumstances, lend the customer the necessary funds to meet margin requirements.

**C. Hong Kong: SFC**

HKCC uses the Theoretical Intermarket Margin System (TIMS) methodology developed by the OCC to calculate margins for each account. Each registered trader account or house account is margined on a net basis and each client account is margined on a gross basis. However, members may request HKCC to allocate those positions belonging to the same client to an offset account in which the margin requirement is computed on a portfolio basis. HKCC generally collects margin on a gross basis. However, spread margin rates are available for spread positions allocated to a specific customer's account or to a house account.

HKCC adjusts open Contracts at least once daily in order to establish the amount of variation adjustment payment each day by or to HKCC members. If in the opinion of HKCC sudden fluctuations of any market operated by HKFE are apparent, HKCC may, during any business day, call for additional margin. Additional margin is payable within one hour of demand by HKCC.

In relation to stock option contracts at SEHK, after each trading day, SEOCH will calculate the premium due to or from each SEOCH member, the margin requirements for the open stock option positions or pending delivery obligations of each SEOCH member, and the payments in relation to stock delivery obligations due for settlement.

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Open options contracts and exercised and assigned delivery obligations for principal and market maker accounts are margined on a net-basis. Client positions are treated differently; open options contract positions are margined on a gross basis. It will then assess a margin requirement based on this valuation. SEOCH collects this mark-to-market margin on a daily basis but is also empowered to collect margin on an intra-day basis (payment in one hour) if market prices move significantly intra-day.

Both HKCC and SEOCH prohibit their members from extending any credit to their clients in relation to margin requirements.

**D. New Zealand: NZSC**

In calculating the amount of an initial margin no offset is allowed by Dealers, for other initial margins due by the client to the Dealer, unless the client has contracts with that Dealer for the opposite position in the same delivery month and in respect of the same commodity. In the event that a client holds with a Dealer a bought and sold contract for the same delivery month in the same class of contract, the Dealer need only obtain from the client the straddle initial margin determined by the Clearing House for that class of contract.

The Clearing House settles Dealers contracts to market daily. Dealers must lodge sufficient cover with the Clearing House to meet any shortage by 12:30 p.m. on the day a call is made. The Clearing House may require settlement of debit balances in clearing accounts on the first Business Day of each month and at such other times as may be determined by the Clearing House.

**E. Sweden: FSA**

Options Market (OM) or member of OM can require that margins are collected to a larger extent than corresponding to the net margin position -- no later than on the fifth day after the transaction day.

**F. Germany: BAWe**

Under the DTB Clearing Conditions each Clearing Member must maintain, on every trading day, collateral to cover all of its contractual obligations. General Clearing Members must require their Non-Clearing Members to provide collateral in an amount at least equal to that determined by the methods prescribed by the DTB.

The Deutsche Börse AG may, on stating the reason, demand that any Clearing Member maintain a higher or supplementary margin on the basis of the Deutsche Börse AG's risk management.

In accordance with the regulations issued by the Lombardkasse, margins are collected as follows:

- Any bank acting as a writer of call options which exceed 300 per cent of the liable capital, pursuant to Section 10 of the Banking Act, calculated on the basis of strike prices (or - acting as a writer of put options - which exceed 100 percent of the liable capital) must immediately provide collateral to cover fully the excess.
  
- Any other Participant, acting as an option writer, must immediately provide collateral whenever a guarantee risk arises for the Lombardkasse and the difference between the strike prices and market prices exceeds 15 percent of the liable capital of the Participant. A guarantee risk invariably arises whenever, in the case of call options (put options) the market values are higher (lower) than the actual strike prices.

In accordance with the regulations of the Lombardkasse, at least 30 percent of the underlying must be available to a Participant selling call options. Moreover, at the request of the Lombardkasse a Participant must provide collateral exceeding by at least 30 percent the value deriving from the strike price of the items involved in the transaction not covered by the underlying securities. If a Participant sells a put option, it must provide collateral equivalent to up to 30 percent of its commitment at the request of the Lombardkasse.

The Deutsche Börse AG calculates the amount of the collateral after the post-trading period on each trading day. If the collateral already provided is insufficient to provide the cover required for the next trading day, the shortfall must have been transferred by 9:45 a.m. of the next trading day to the Deutsche Börse AG's Land Central Bank account. Each Exchange Participant is required to provide the collateral calculated for him in cash or securities in a timely manner.

#### G. Malaysia: SC

For margining purposes, MDCH uses TIMS. MDCH adopts a gross margining concept where each client account of a clearing member is margined separately. The total margin for a clearing member is the sum of the margins for all the individual client accounts of the clearing member. The proprietary position of a clearing member is margined on a net basis. A market maker account is treated in the same way as any other client account where long and short positions in the same contract class within the one account are margined on a net basis.

MFCC requires clearing members to lodge initial margins to secure the exposure on open positions. The initial margin is set for each commodity and may be varied from time to time at the discretion of MFCC. The level is based on the price volatility of the commodity and is intended to cover the largest reasonably anticipated price movement in any single business day.

MFCC collects margins on a net basis on house account and the client account is

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margined on the higher side of the gross open position.

All open positions are valued daily against a settlement price determined by the clearing houses and the resulting profits and losses are immediately posted to the accounts of the clearing members. In respect of MFCC, if the amount of margins on deposit in a client's account is insufficient to provide the cover required for the next trading day, the shortfall must be paid by 11:00 a.m. on the next trading day. In respect of MDCH, amounts due from members are required to be paid by the respective clearing member in cash before the start of trading on the next business day.

## V. STANDARDS OF PERMITTED COLLATERAL FOR DEPOSIT/ MARGIN

The Exchange should limit the value of the letters of credits (LOCs) pledged as margin to a Member's account to no more than 25 percent of standing margin. With the LOCs accepted, the NSE should ascertain that the bank issuing the LOCs or Guarantees has the financial capacity to honour such commitment. A list of banks approved for such purpose should be established (recognising that this would be a very short list at present, but this would allow new banks to be added as appropriate). Further, standards should be established as to the total amounts of such instruments which a single bank could issue or guarantee (either as an absolute value or as a percentage of the bank's capital).

Given the current Exchange approach to establishing net-worth and capital adequacy (based entirely on up-front deposits and margins), customer or constituent LOCs should be prohibited, or at least strongly discouraged. In fact, the Exchange should consider offering a financial incentive to Members who do not use customer/constituent LOCs. Strict standards should be established if third party guarantees are permitted for a Member to use on behalf of a constituent's account. These guarantees should be documented in a form acceptable to SEBI and the guarantor should maintain an account with the Member with adequate equity (marked to market and given at least 50 percent haircuts) to satisfy the potential exposure from the guarantee.

### What are permitted collateral for deposit/margin in other jurisdictions?

#### A. United States of America

##### 1. CFTC

The CFTC does not have any regulations regarding permitted collateral. The majority of the exchange clearing houses accept as margin cash and U.S. Treasury Securities. Some clearing houses also accept letters of credit under the terms and conditions that they prescribe. The CME accepts securities haircut at 50 percent in a cross-margined account.

The futures clearing organisations have also taken steps to reduce the proportion of standing margin held in the form LOCs. The Board of Trade Clearing Corp (BTCC) also limits the value of LOCs which may be pledged as margin by a clearing member to 25 percent of the firm's adjusted net capital and does not accept customer letters of credit at all. To monitor LOCs, the BTCC has developed a daily print-out which shows LOCs as a percentage of BTCC clearing member original margin; the BTCC reviews this print-out on a daily basis. The BTCC estimates that, on the average, LOCs constitute approximately 5 percent of original margin payments of BTCC members.

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Futures clearing organisations also have taken steps to reduce the likelihood of excessive concentrations of LOCs issued by a single issuing bank.

## 2. SEC

OCC accepts cash, government securities, letters of credit, and valued securities (certain common stocks) to satisfy margin requirements. OCC values all securities based on closing market prices and deducts a percentage from that value to reflect market price volatility.

No margin is required in respect of a stock index option contract carried short in a customer's account where the customer has delivered to his broker-dealer a Market Index Option Escrow Receipt (MIOER). The collateral permitted to underlie a MIOER may be: (1) cash; (2) cash equivalents; (3) one or more qualified securities; or (4) a combination of the foregoing.

MIOERs are issued by banks and trust companies approved by OCC. MIOERs can be submitted by OCC clearing members to cover short call positions in broad-based stock index options held in a clearing member customer's account in lieu of margin. Banks issuing MIOERs are required under OCC rules to, among other things, certify that the deposited collateral for the MIOER is of sufficient market value.

### B. United Kingdom: SIB/SFA

The clearing house/exchange determines the type of collateral that it will accept from its member firms to cover margin requirements. Apart from cash, the types of collateral commonly used are bank guarantees, securities and government debt instruments. There are no restrictions on the types of collateral a firm may accept from customers. However, a firm is subject to financial supervision rules; accordingly, the type of collateral accepted will affect its regulatory financial resources requirements.

### C. Hong Kong: SFC

HKCC's rules allow initial margin in the form of cash, bank guarantees, and Exchange Fund Bills and Notes.

SEOCH may accept as margin collateral cash, letters of credit, bank guarantees, bankers' drafts, bank cashiers' orders, securities and other property as may from time to time be designated by SEOCH.

### D. New Zealand: NZSC

Cover provided to the Clearing House may only take the form of cash. Cover provided to dealers of the New Zealand Futures and Options Exchange by clients may take the form of the following:

- bank guarantee;

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- shares or debentures listed on the New Zealand Stock Exchange that are approved by the Business Conduct Committee of the New Zealand Futures and Options Exchange;
  - government and local authority securities;
  - gold and silver bearing an approved assay mark.

In the event that margins are deposited in cash, the custodian clearing member is responsible for the investment in daily repurchase agreements, being interest payable to the member.

**E. Sweden: FSA**

Collateral permitted by OM is divided between such collateral which is accepted for a customer in relation to a securities firm and such collateral which is accepted for a customer or a securities firm relative to the clearing function. In addition to this collateral OM has edited a list of ariables valid for closing contracts of different instruments.

**F. Germany: BAWe**

Every Exchange Member has to maintain collateral on each trading day to cover its contractual obligations in the amount prescribed by the Deutsche Börse AG. The Member may provide such collateral either in cash or in securities acceptable to the Deutsche Börse AG.

- Collateral in cash is provided by the Clearing Member timely instructing the Land Central Bank to honour the transfer instructions (Lastschriften) received from the DTB with respect to its Land Central Bank account and to transfer the amounts in question to the Land Central Bank account of the DTB.
- Collateral in securities must be deposited by each Clearing Member in the Clearing Institution's pledged securities account at the Deutscher Kassenverein AG (DKV). For this purpose, the Clearing Institution grants a lien in favour of the Deutsche Börse AG on all securities deposited in its pledged securities account through an appropriate pledge agreement. The Clearing Institution notifies the DKV of the execution of such a pledge agreement. The securities are deposited by the Clearing Member timely instructing the DKV to transfer the securities to its pledge account at the DKV. The DKV then informs the Deutsche Börse AG of such transfer. Clearing Members may, until 30 minutes prior to the end of the last post-trading period of any trading day, request that the Deutsche Börse AG release pledged securities. If compliance with such a request would render the remaining collateral inadequate for the next trading day, the Deutsche Börse AG will only notify the DKV that it approves of such release upon provision of cash to the amount of the shortfall by 9:45 a.m. of the next trading day. The Deutsche Börse AG determines which securities it will accept as collateral and the pledge value of such securities.

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Frankfurt Stock Exchange:

Collateral may be provided in the form of cash, securities eligible as collateral for lombard loans of the Deutsche Bundesbank or in any other form acceptable to the Lombardkasse. Debt securities may be counted at up to 90 percent, and equities up to 75 percent, of their market values.

**G. Malaysia: SC**

MFCC's rules allow initial margins in forms other than cash. Currently, bank guarantees are accepted as collaterals.

**In relation to MDCH, clearing members are permitted to pledge approved collaterals with MDCH for the purpose of covering margin requirements, lodgements for security deposits and contributions to the clearing fund. MDCH has approved as acceptable collateral, Irrevocable Standby Letters Of Credit (ILOC) issued by the local Tier-1 commercial banks. The minimum amount of ILOC that may be issued to the clearing house is MYR 100,000.**

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VI. BROKER QUALIFICATION AND REGISTRATION

Broker qualification and registration should be a priority concern, particular for those persons performing roles in the futures market. Supervisors should also be required to demonstrate their technical competence with regard to industry rules, regulations and compliance procedures. Qualification examinations should be developed for both brokers and sub-brokers, as well as for supervisors, and successful completion of such examination should be required in order to act in these capacities.

**How do other jurisdictions address broker registration and qualification?**

**A. United States of America**

**1. CFTC**

The categories of registrants are Brokers, Introducing Brokers (who bring clients to the brokers and do not handle customer money), Customer Trading Advisors, and Traders. Any person associated with any group of registrants listed here who solicits or accepts customer orders or who supervises persons who do so is required under the CEA to register as an "Associated Person" (AP). The AP is the person who solicits business from, and deals directly with, the customer with respect to his account.

The CFTC has delegated to NFA, an industry-wide self-regulator, a majority of the registration processing function.

The basic registration application form required of brokers and trading advisors is the Form 7R which requires disclosure of the applicant's name, address, branch offices, and principals, as well as detailed information about the disciplinary and criminal history of the firm.

Each application must be accompanied by a Form 8R completed by each person who is a principal (a firm official responsible for the applicant), along with the fingerprints of each principal. The Form 8R requires disclosure of information on the employment, residential, and educational history of the applicant, and requests detailed information about the disciplinary and criminal history of the principal.

Anyone applying for broker, trading advisor or associate person registration must supply to NFA satisfactory evidence that they have taken and passed the National Commodity Futures Examination. It covers areas in which the NFA feels persons involved in opening and handling customer accounts in futures contracts and options on futures should be able to exhibit knowledge and proficiency in order to effectively serve their clients.

**Ethics Training for Registrants:**

The Futures Trading Practices Act of 1992 (FTPA) requires ethics training for all CFTC registrants. Rule 3.34 requires new Commission registrants to attend four

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hours of ethics training within six months of initial registration and periodic one-hour refresher courses every three years thereafter.

## 2. **SEC**

Registration as a broker-dealer generally is the only category of registration available to a person acting as a financial intermediary in derivative securities products. In addition to registering with the Commission, a broker-dealer must become a member of one or more appropriate self-regulatory organisations. Every registered broker-dealer doing business in derivative securities products (other than government securities) also must become a member of the Securities Investor Protection Corporation, unless the broker-dealer's principal business is conducted outside the United States.

Associated persons of a broker-dealer, such as partners, officers, directors, branch managers, and employees, must meet certain qualification requirements if their functions are not solely clerical or ministerial. These requirements include filing an application (Form U-4) that discloses the person's employment, personal, criminal and regulatory disciplinary history, and passing an SRO securities examination. In addition, associated persons of a broker-dealer generally must be fingerprinted, and these fingerprints must be submitted to the Attorney General of the United States.

The options SROs require that all registered representatives pass a general securities examination that includes options questions. Options supervisors must pass a general principal examination plus a separate options principal examination.

### **B. United Kingdom: SIB/SFA**

Authorisation may be obtained through membership of an SRO or from SIB. In either case the applicant is required to show that it is fit and proper to carry on the investment business and provide the service intended. The fit and proper standard is the cornerstone of the investor protection regime.

SIB and the SROs apply three main criteria to the assessment of fitness and properness: honesty, competence and solvency, and they take a broad view of the scope of each of these. They may take into account any matter relating to any person employed or to be employed by, or who is an officer or key member of staff of the applicant, or who is associated with the applicant, together with any matter relating to holding companies or other controllers of the applicant.

An applicant is required to demonstrate an understanding of and commitment to the rules relevant to its proposed business and that it has established and will maintain procedures enabling and securing compliance with these rules and the standards set by the ten Statements of Principle issued by SIB under the FSA.

### **C. Hong Kong: SFC**

All exchange members, clearing members, registered dealers, registered advisers and registered representatives in Hong Kong must satisfy initially and continue to satisfy

"fit and proper" criteria. The burden for initial registration is upon the applicant. This essentially involves satisfying the Commission on the following elements: financial status, educational or other qualifications or experience, ability to perform functions efficiently, honestly and fairly, reputation, character, financial integrity and reliability.

**D. Sweden: FSA**

Licenses for securities activities are granted by the FSA and may be given to firms with limited liability if the company statutes are in accordance with the new Securities Business Act and other relevant acts, if the company is fit to do business of such a kind, if the business is assumed not to hurt public interests and if the company otherwise corresponds to the legal requirements.

No one but a firm licensed to do securities business may act as an over-the-counter (OTC) market maker. Otherwise, there are no legal claims on the one who wants to do market making in Sweden. But acting as a market maker in the money market is not permitted without a license from the National Debt Office and the Central Bank. This market maker task is regulated in a special contract between the National Debt Office and the market maker. A corresponding situation is valid for the one who wants to do market making for the OM.

**E. New Zealand: NZSC**

Introducing Brokers and Dealers require authorisation by the Securities Commission.

The by-laws of the Clearing House provide that all applicants for clearing membership shall satisfy the Clearing House that the applicant has an acceptable standard of business integrity and financial probity, is of good standing and is a fit and proper person to become a clearing member.

In determining whether to approve an application the Exchange must be satisfied that the person:

- has business integrity, financial probity and good character,
- may reasonably be expected to comply with the rules of the Exchange and with the spirit of the rules, and
- meets any other requirements for the time being specified by the Exchange for the purposes of the rules.

**F. Germany: BAWe**

Exchange Member:

The Board of Governors decides upon admission of an applicant firm. The applicant must name in its application the person or persons who are to be given authority to enter into options and futures transactions at the Exchange.

Admission shall be granted if:

- the owner or manager of the firm in question, or the person designated by statute, charter documents or contractual arrangements to engage in options and futures trading on behalf of such firm and authorised to enter into options and futures transactions at the Exchange, has the requisite reliability and professional qualification for trading at the Exchange;
- the orderly settlement of options and futures transactions at the location of the Exchange is assured;
- the technical requirements for linkage to the EDP-System of the Exchange are fulfilled; and
- the applicant has provided such security as may be required by law.

An Exchange Participant may apply for admission as a Market Maker for one or more products. The Board of Governors will grant any applicant a Market Maker License if the persons named in the application for such form of trading have the requisite trading experience to act as Market Makers.

**G. Malaysia: SC**

The applicant must demonstrate or provide evidence of business integrity and financial probity as well as have an adequate level of product knowledge and knowledge of the risks and obligations of trading in exchange-traded derivatives contracts. All exchange members must satisfy the fit and proper test including good business standing and integrity, and satisfy the Management Board that the persons to be responsible for its trading on the exchange have sufficient knowledge and experience in futures trading.

## VII SALES REPRESENTATIONS AND DISCLOSURE

- **"Know your Customer"**
- **"Suitability"**
- **Disclosure of Risk to Customers**
- **Monitoring Broker Sales Practice**

Brokers need to adopt account approval and "Know Your Customer" practices whereby the broker would gather the essential information about each client regarding objectives, experience, financial resources and related items.

Clients often see the potential rewards of investing/trading without proper recognition of the risks. Especially in light of the new and increased risks in derivatives, disclosure will be of vital importance. Appropriate risk disclosure documents should be prepared, presenting in layman's language explanations, examples and illustrations of such risk. Prior to trading in any derivative, client signs the risk disclosure document acknowledging that the risk disclosure document has been received, read and understood, and that the client is willing and able to bear such risk. On-going monitoring of broker sales practice needs to be done to ensure they continue to trade in a manner consistent with such approval.

### **How do other jurisdictions ensure proper sales practices?**

#### **A. United States of America**

##### **I. CFTC**

The CFTC has required NFA to adopt a "know your customer" rule which has industry-wide applicability. The rule requires each NFA member, with the exception of under the exclusive jurisdiction of the CFTC to obtain from each customer his age, occupation, income, net worth and previous investment experience. In turn the broker must provide a special risk disclosure statement to the prospective customer where it appears necessary.

Before a futures commission merchant or an introducing broker may open a commodity account for any customer, the customer must be provided with:

- The written risk disclosure statement in CFTC Rule 1.55 which sets forth the risks, costs and mechanics of futures trading. Each Broker must obtain from each customer an acknowledgement, signed and dated by the customer, stating that the customer received and understood the disclosure statement. This acknowledgement and all other acknowledgements referred to herein must be retained in the offices of the broker.
- The written risk disclosure statement in Rule 190.10 (c), which states that before accepting property other than cash from or for the account of a customer to margin, guarantee or secure a commodity contract, a broker must first provide a

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written disclosure statement which sets forth in abbreviated form the distribution scheme for such property in the event the broker becomes insolvent. The statement must be signed and dated by the customer, stating that the customer received and understood the disclosure statement.

CFTC rules require each registrant to diligently supervise the activities of all APs. Such supervision includes the use of all promotional material. NFA requires all NFA members to have written supervisory procedures for the review of all promotional material for compliance with its rules. NFA may require any Member for any specified period to file copies of all promotional material with NFA after its first use.

CFTC prohibits any person, in connection with any order or contract of sale of any commodity for future delivery, from making false or misleading statements in connection with a transaction.

Advertising in a manner to defraud a client or prospective client or involves any transaction, practice or course of business which operates as a fraud or deceit upon a client is prohibited.

NFA's Compliance Staff review national and regional newspapers to determine whether advertising complies with the standards set forth in NFA. NFA further conducts a "pitch program," whereby it exchanges market information with 25 states, a voluntary pre-publication advertising submission program which operates to screen advertising, and a telephone client solicitation program to test oral sales pitches.

NFA and the exchanges have sales practice audit responsibilities and the scope of such audits includes: proper order handling; the handling of discretionary accounts; adequacy of internal supervision; fraudulent or high-pressure sales communications; compliance with disclosure requirements; proper handling and disposition of customer complaints; determining whether promotional materials are fraudulent.

The CFTC relies on individual registrants and SROs, *i.e.*, NFA and the exchanges, to provide for direct supervision of industry sales practices. The CFTC's role is that of an overseer and in that capacity, the CFTC's staff conducts regular reviews of the SROs' sales practice audit program to determine whether SRO programs meet CFTC standards and to ensure the adequacy and proper co-ordination of SRO efforts.

## 2. SEC

No member of an options exchange may accept an options order from a customer unless the customer's account has been approved for options transactions. In approving a customer's account, a broker-dealer must exercise due diligence to learn the essential facts as to the customer and his investment objectives and financial situation. Specifically, broker-dealers are to seek at a minimum the following information about a customer: investment objectives, employment status, estimated annual income from all sources, estimated net worth, estimated liquid net worth, marital status, age, and investment experience and knowledge. Background and

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financial information of customers who have been approved for options transactions shall be maintained at both the branch office serving the customer's account and the principal supervisory office having jurisdiction over that branch office. Copies of account statements of options customers must be maintained for the most recent six-month period.

The options SROs also have options suitability rules that prohibit member firms from recommending to any customer any options transactions unless they have reasonable grounds for believing that the entire recommended transaction is not unsuitable for the customer, based on information furnished by the customer after reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other information known by the member or associated person. The suitability rules also prohibit broker-dealers from recommending opening transactions unless the person making the recommendation has a reasonable basis for believing that the customer has such knowledge and experience in financial matters that he reasonably may be expected to be capable of evaluating the risks of the recommended transaction, and is able to bear the financial risks of the transaction.

In addition to the suitability requirements, the options SROs have established specific written sales practice requirements and standards concerning uncovered short options transactions. Specifically, the options SROs require that members and member organisations establish a minimum net equity requirement for approving and maintaining customer accounts for uncovered short options transactions. The options SROs also require that members and member organisations furnish customers a written description of the risks involved in uncovered short options transactions, in addition to the Options Disclosure Document (ODD), at or prior to the customer's initial uncovered short options transaction.

OCC prepares for Commission approval an ODD that describes the uses, mechanics and risks of options trading. The ODD is designed to enhance investor understanding of standardised options by separating information about the issuer from information relating to options and the risks and characteristics of trading options. Rule also requires broker-dealers to furnish customers with a copy of the ODD before approving a customer's account for trading options or accepting a customer order to purchase or sell a standardised option contract. The broker-dealer's records for each options account must also contain the date the ODD was provided to the customer.

The rules of the options SROs establish detailed standards concerning the content and manner or presentation of options advertisements, educational material and sales literature. All advertisements, educational material, and sales literature must be approved in advance by a firm's Compliance Registered Options Principal. Broker-dealers also are required to submit advertisements and educational material to options SROs for approval or review prior to their use.

In general, the rules adopted by the options SROs provide that sales and advertising material must:

- not be false and misleading;

- not promise specific results;
- not contain exaggerated or unwarranted claims, opinions, or forecasts;
- not contain clauses disclaiming responsibility for its content;
- when discussing the uses or advantages of options, contain a warning that options are not suitable for all investors;
- balance statements that describe potential opportunities and advantages with appropriate reference to the corresponding risks; or
- when discussing the uses or advantages of options, reflect the special risks and complexities of options transactions.

**B. United Kingdom: SIB/SFA**

A firm must take reasonable steps that it does not make a recommendation to a private customer or effect or arrange a discretionary transaction with or for any customer, unless the recommendation or transaction is suitable for that customer. In order to comply with this rule, a firm must first have received sufficient information from that customer in order to decide whether it is private or non-private. Similarly, for any recommendation or transaction to be suitable for a customer, the firm must have obtained sufficient information from the customer to be able to ascertain the suitability of the recommendation or transaction.

In respect of private customers a firm must not recommend a transaction, arrange or execute a transaction or act as a discretionary manager in respect of warrants or derivatives, unless it has sent that private customer the prescribed form warning notices and obtained a copy of those notices signed by the customer in circumstances where the firm is satisfied that the customer has had a proper opportunity to consider their terms. A firm must not recommend to a private customer a transaction on an investment which is not readily realisable unless it has given the private customer the required warning and disclosure.

A firm which issues promotional material to the general public must apply appropriate expertise and be able to show that it believes on reasonable grounds that the advertisement is fair and not misleading.

Where the advertisement relates to a specific investment SFA has set out general contents requirements and specific contents requirements which will apply depending upon the nature of the advertisement. In addition it sets out risk warnings which will need to be included depending on the nature of the investment being advertised.

A firm must take reasonable steps, including the establishment and maintenance of procedures to ensure that its officers and employees, and officers and employees of its

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appointed representatives, act in conformity with their and their employer's relevant responsibilities under the regulatory system and the general law.

### **C. Hong Kong: SFC**

HKFE members are required to have each client complete and sign a "Client Information Statement". The Member is required to deliver to the client a written statement giving the name of the member, the category of membership, the name of the employee handling the client's account and registration particulars of the member and the employee. HKFE members must take all reasonable steps to establish the true and full beneficial identity of each of their clients, and of each client's financial situation, investment experience, and investment objective. Having regard to information disclosed by a client and other circumstances relating to the client which the member is or should be aware of through the exercise of due diligence, the member must, when making a recommendation or solicitation, ensure the suitability of such recommendation or solicitation for that client as is reasonable in all circumstances. Members must assure themselves that the client understands the nature and risks of a futures / options contract and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in such futures / options contracts.

Before entering into an options client agreement with any person, SEHK option trading rules require that an options trading member obtain sufficient information in respect of that person's beneficial identity and financial situation, investment experience and investment objectives to enable the options trading member to assess the type of stock option contract suitable for that person.

An SEHK stock options trading member must complete a client information checklist and maintain a record of the information. The options trading member must approve in writing the entry of each options client agreement and must provide each client with the SEHK's booklet "Understanding Stock Options (and their Risks)." Each options trading member must maintain full and up-to-date records of the name, addresses, contact individuals and contact numbers of each client and of any person authorised and designated by that client to act for that client.

SEHK and HKFE members are required to have a risk disclosure statement signed by their clients before trades are effected.

At HKFE, all promotional material must be approved by the HKFE and filed with the SFC. In addition, any HKFE member who knowingly disseminates false, misleading or inaccurate reports concerning market information or conditions that affect or tend to affect the price of any HKFE contract or any commodity underlying an HKFE contract shall be liable to disciplinary proceedings.

An SEHK member would face disciplinary action by the SEHK if he or it knowingly disseminates or carelessly allows it to be disseminated, false, misleading or inaccurate market information which affects or tends to affect the price of any issue of securities.

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Promotional material is also subject to statutory anti-manipulation and anti-fraud provisions.

The Codes of Conduct at HKFE and SEHK require members to ensure at all times that they have adequate resources to supervise diligently and do supervise diligently their employees and other persons appointed by them to conduct business. Exchange members acting on behalf of a client are also required to ensure at all times that any representatives made and information provided to the client are accurate and not misleading.

**D. New Zealand: NZSC**

All dealers must obtain prescribed written acknowledgements from clients. Clients are required to sign an agreement form acknowledging that they have read and understood the Risk Disclosure Statement. All clients are also required to complete prescribed client agreement forms detailing the identity of the client.

**E. Sweden: FSA**

The FSA has required that the end-customers will be well aware of the specific risks connected to the derivative trade and that every such customer shall sign the opening and pledge documents. A customer intending to conduct transactions with derivative instruments shall, before he is allowed for the first time to undertake any transactions, be provided by the securities institution with clear written information about the specific risks which transactions with derivative instruments can involve.

**F. Germany: BAWe**

Member banks have to get their private customers to sign a form to assure their "Termingeschäftsfähigkeit" (risk disclosure statement). In addition, rules of conduct set down in the new securities trading act (WpHG), Section 31 (2) obliges the investment firm to require from its customers information about their experience in or knowledge about transactions which are contemplated to be the subject of security services, about their goals pursuant to such transactions and about their financial situation and to provide all information useful for the purpose to its customers and in view of the type and volume of the proposed transaction.

**G. Malaysia: SC**

Section 53 of the FIA requires futures brokers to give their clients information that explains the risks associated with trading in futures contracts. This information includes a *risk disclosure statement* that is prescribed in Schedule 3 of the Futures Industry Regulations 1995 (FIR). In addition, the broker must give the client a copy of the proposed *client agreement* which contains the minimum terms that are prescribed in the business rules of the exchange. These provisions ensure that a client, and in particular a speculative client, is fully aware of its obligations in relation to futures trading.

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Section 52B of the FIA places a legal duty on all intermediaries when giving advice to clients. The provision requires a futures intermediary to have a reasonable basis for recommendations made to its clients, in that sufficient inquiry is made into the financial standing of the client and his risk appetite, as well as into the subject matter of the recommendation.

## **VIII RECORDKEEPING**

Additional records should be added to the last of the records currently required to be maintained by the member: audit trail records, customer account record, stock record, margin calls made and met, information regarding account and loan guarantees, documentation of LOCs and signed risk disclosure documents.

A guide to the necessary books and records should be compiled which should include: titles and designation codes, content and purpose of each record, standard for each form used, period of retention for each record, and location at which the records must be accessible for audit or review.

Prior to launch of derivatives trading it is essential that all Members have in place complete and adequate recordkeeping systems. These systems should be tested through mock trading and evaluated by NSE (under SEBI oversight) prior to approval of such Member for trading.

### **What are the recordkeeping standards in other jurisdictions ?**

#### **A. United States of America**

##### **1. CFTC**

Books and records are to be kept for a period of five years and to be readily accessible during the first 2 years of the 5-year period.

Brokers must prepare and keep current ledgers which show each transaction affecting asset, liability, income, expense and capital accounts consistently with the form 1-FR and make a formal computation of their adjusted net capital and their minimum financial requirements as of the close of business each month.

Each FCM which invests customer funds must keep a record which shows the details of the investment, including the size and type of investment, the date of the investment, and any disposition made of the investment.

Rule requires an FCM to compute each day the customer funds in segregated accounts and the FCM's residual interest in those funds.

FCMs and IBs must keep full, complete, and systematic records, together with all pertinent data and memoranda. Records to be kept include all orders (filled, unfilled, or cancelled), trading cards, signature cards, street books, journals, ledgers, cancelled checks, copies of confirmations, copies of statements of purchase and sale, and all other records, data and memoranda which have been prepared in the course of its business.

FCMs and IBs are required to prepare written records of a customer order immediately upon receipt. The records must include the customer identification and

order number, and must be time stamped to the nearest minute from the time the order is received. For option customers the record shall record to the nearest minute the time the order is transmitted for execution.

Rule requires FCMs and IBs to regularly prepare and maintain account ledgers and transaction journals which record, for each customer, charges and credits to an account, and detailed information about futures and option transactions.

Rule requires FCMs to maintain records of all securities and property received from customers to margin, purchase, guarantee, or secure a futures or exchange option transaction. The records must show where the property is deposited and any other disposition of the property.

Rule requires FCMs and IBs to keep a record of each account carried, the name and address of the customer, and the customer's principal occupation or business. The record must also show the name of any person guaranteeing the account or exercising any control over it.

Rule 1.37 (b) requires each FCM carrying a futures or option omnibus account for another FCM, foreign broker, or other person to maintain a daily record of the positions in each such account.

## 2. SEC

Broker-dealers are required to keep records relating to, among other things:

- daily transactions and receipts and disbursements of money;
- the firm's assets and liabilities, income and expense, and capital accounts;
- each cash and margin account of every customer and each account of the firm and its partners that reflects all purchases, sales, receipts, and deliveries of securities for such accounts; and
- the location of various securities for which the firm is responsible.

Generally, records must be preserved for three or six years with the first two years in an easily accessible place.

The Commission and the SROs have access to registered broker-dealers' books and records. These books and records, which are treated as confidential, must be available for immediate examination on the firms' premises.

### B. United Kingdom: SIB/SFA

A firm must ensure that its accounting records shall as a minimum contain:

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- entries from day to day of all sums of money received and expended by the firm whether on its behalf or on behalf of others, and the matters in respect of which the receipt and expenditure takes place;
  - a record of all income and expenditure of the firm explaining its nature;
  - a record of all assets and liabilities of the firm including any commitments or contingent liabilities;
  - entries from day to day of all purchases and sales of investments by the firm distinguishing those which are made by the firm on its own account and those which are made by or on behalf of others;
  - entries from day to day of the receipt and dispatch of documents of title which are in the possession or control of the firm; and
  - a record of all investments or documents of title in the possession or control of the firm showing the physical location, the beneficial owner, the purpose for which they are held and whether they are subject to any charge.

A firm must ensure that its accounting and other records contain details of exposure limits for trading positions, and for commitments under its adequate credit management policy, which are appropriate to the type, nature and volume of business undertaken and that the information contained in the records is capable of being summarised in such a way as to enable actual exposures to be measured readily and regularly against these limits.

A firm must maintain its records in a manner such that they disclose, or are capable of disclosing, in a prompt and appropriate fashion, the financial and business information which will enable the firm's management to:

- identify, quantify, control and manage the firm's risk exposures;
- make timely and informed decisions;
- monitor the performance of all aspects of the firm's business on an up-to-date basis;
- monitor the quality of the firm's assets; and
- safeguard the assets of the firm, including assets for which the firm is responsible belonging to customers and other persons.

A firm must keep all records as well as any working papers necessary to show the preparation of any reporting statement or any other periodic return to SFA. A firm

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must keep these records and working papers for a period of six years after the date on which they are first made or prepared.

**C. Hong Kong: SFC**

The SFC has statutory access to all dealers and advisors records at all reasonable times. HKFE, SEHK, and the clearing houses have access under their rules to their members' records on demand or via inspection with or without prior notice to the member. The HKFE employs audio / video monitoring of open-outcry trading on its floor, and both exchanges capture and retain all order and transaction data. Receipt of customer orders and origination of house orders must be time stamped immediately.

**D. New Zealand: NZSC**

NZFOE rules require Dealers to maintain internal records showing the time, date and nature of instructions received from, and trades executed for, clients and to maintain separate internal records showing the time, date and nature of its own orders and trading and the source of funds used for that trading. Such records are to be maintained for a period of not less than two years from the date of a trade.

Dealers are also required to maintain such accounting records as correctly recorded and explain the transactions of the Dealer and the financial position of the Dealer and as will enable compliance with these NZFOE Rules to be conveniently ascertained by the Business Conduct Committee and otherwise conveniently and properly audited.

The SYCOM Trading New Zealand system used by NZFOE allows the printing of a live trading log which records in real time all trades which have occurred and all other activities (i.e., order entered, messages sent and received) which have occurred from the particular Trader Workstation. Dealers are also required to print and retain the daily trade detail report which prints a list of all trades executed during a selected session and lists the trade details in order of trader and contract.

NZFOE members are required to provide the Business Conduct Committee with such financial reports, within such time, as the Business Conduct Committee requires. Such information shall include true and correct statements of the following:

- a monthly return of the Dealer's position with regard to clients' funds, within two working days of the last business day of the month;
- a monthly return of the dealer's financial position, within 10 working days of the last business day of each month; and
- signed audited annual financial accounts, within three months of the Dealer's annual balance date.

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**E. Sweden: FSA**

The following records shall according to OM rules be maintained by an exchange member:

- all transactions entered into by brokers/market makers including copies of settlement notes issued to customers;
- all entries, credits and debits on each customer account; and
- diskette license information on collateral calculation.

The securities firms have to save settlement notes for ten years. The FSA is entitled to get at any time information out of these notes. By delegation from the government the FSA may provide for the current recordkeeping, annual accounts and reports.

Regulation 23 of The Future Industry (Client Funds) Regulations 1990 sets out the recordkeeping responsibilities of dealers with respect to client money and property, as follows:

1. Every dealer shall at all times keep, in relation to the clients of the dealer, in such manner as will enable the audit thereof to be conveniently and properly carried out, accounting and other records that are separate from any other records of the dealer and correctly record and explain:

- (a) Particulars of all amounts deposited in, and of all amounts withdrawn from, each client bank account;
- (b) Separately from, but in addition to, the particulars referred to in paragraph (a) particulars of all amounts deposited in, and of all amounts withdrawn from, each client bank account pursuant to regulation 18 of the regulations;
- (c) Particulars of all amounts credited or debited to each client funds account;
- (d) Particulars of all specified client investments of the dealer;
- (e) Particulars of all other client property deposited in safe custody or held by the dealer;
- (f) Particulars of all dealings of each client with the dealer, including details of all amounts credited or debited to each client in each client bank account and each client funds account;
- (g) Separately from, but in addition to, the particulars referred to in paragraph (f), where the client is another dealer who maintains a client funds account with the dealer, particulars of all amounts credited or debited by the dealer in respect of the client funds account of the other dealer.

1. Every dealer shall ensure that the client records of the dealer are available on request for inspection by its auditor and by any person authorised by any authorised futures exchange of which the dealer is a member.

**F. Germany: BAWe**

Section 9 of the Securities Trading Act (WpHG) states that credit institutions must report to the Federal Securities Supervisory Office (BAWe) all transactions not later than the working day following the day on which they were executed. In addition, § 34 WpHG requires every Investment Services Enterprise (ISE) to record all detail information on customer transactions and to maintain these records for at least six years. These records must be produced upon request of the BAWe. Pursuant to § 35 WpHG the BAWe is authorised to require the ISEs to keep additional records to the extent necessary for the BAWe to monitor the obligations of ISEs.

Pursuant to § 1b of the Exchange Act (BörsG) the market supervision units of the exchanges (HÜSt) shall systematically and completely record all data regarding exchange trading and the settlement of exchange transactions. At the DTB's fully electronic trading system a complete and exact audit trail of all exchange transactions is automatically recorded and documented. All statistical market data is recorded and documented as well (§ 28 of the Exchange Rules).

Pursuant to § 22 of the Exchange Rules the data received by exchange participants through the EDP system may only be used for their own purposes, including the provision of advice to customers. All data entered by exchange participants into the EDP system, as well as all reports and information that the exchange receives from exchange participants or persons conducting reviews, shall be treated confidential. The Board of Governors shall publish trading figures relating to options and futures transactions. It may also publish other information in a manner that is suitable for informing the public on market developments. The identity of individual exchange participants shall not be revealed without their prior consent.

Each Participant's bookkeeping must correspond to the principles of proper bookkeeping and balance sheet preparation and must consequently be: complete; correct; punctual; orderly; clear and easily surveyed; and verifiable.

Taking as an example share options, the bookkeeping must record the following information:

- internal contract (voucher) number;
- transaction date;
- parties (customer / DTB Clearing House, GCM);
- contract designation;
- number of contracts;
- expiration date (month);
- option price; and
- basic price.

Furthermore, it must be possible to classify the positions according to various aspects; in particular, it must be possible to see the difference between trading for own account and customer orders.

It goes without saying that the competent supervisory authority - in particular, the Federal Banking Supervisory Office as far as banks are concerned - has the right of inspection and examination. Pursuant to the Exchange Rules, the DTB also has the right to inspect the business transactions using an auditor.

#### **G. Malaysia: SC**

Section 36 of the FIA requires exchange companies, clearing houses for exchange companies, futures brokers and futures fund managers to keep accounting and other records and prepare and submit to the Commission profit and loss account and balance sheets. In addition, they also have a statutory duty under the Companies Act 1965 to maintain accounting and other records.

Section 54 of the FIA further provides for the futures brokers to maintain records relating to receiving instructions from their clients. All futures brokers must keep separately from other records such records which correctly record and explain trading in futures contracts by the broker on the broker's own account. These records must be kept for five years. All other records pertaining to clients' details must be kept for seven years.

Section 95 of the FIA provides that an exchange company, a clearing house or a licensed person must produce such books, accounts and records kept by it or him in connection with or for the purpose of his business or in respect of any trading in futures contract as the Commission may require and provide such other information relating to its or his business or trading in futures contracts as the Commission may require.

Under Section 49 of the FIA, a broker is required to give a contract note for every transaction that it undertakes on behalf of a client. The contract note must comply with Regulation 13 of the FIR, which requires among other things, that the contract note be given within two days of trade execution. The contents of the contract note are specified in sub-regulation 13 (3) and 13 (4) and include:

- name and address of the client;
- name of the futures exchange on which the contract was executed;
- date of the transaction;
- a description of the futures or option contract, including the underlying instrument, the contract price, month and year;
- the number of contracts traded;

- the total number of commission, trading and other fees charged;
- whether it is a buy or sell order;
- in the case of an option, the amount of the premium and the exercise price.

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## APPENDIX A IOSCO WORKING PARTY 7

### PRINCIPLES FOR THE OVERSIGHT OF SCREEN-BASED TRADING SYSTEMS FOR DERIVATIVE PRODUCTS

The regulatory authorities responsible for oversight of screen-based trading systems for derivative products, where governmental, quasi-governmental, or private ("relevant regulatory authorities"), should articulate the jurisdictional interest and supervisory principles applicable to the organizations responsible for the system such as an exchange ("system sponsor"), the organization or organizations which provides or provide the hardware, software, and/or the communications network and related services ("system providers"), the persons authorized to execute transactions on the system such as a broker-dealer ("system users")<sup>1</sup> and persons with financial exposure to the system ("system customers"). These principles should reflect the shared objectives of ensuring that, among jurisdictions, the levels of investor protection and regulation are adequate.

To that end, it is suggested that jurisdictions adopt the following ten non-exclusive, general principles for the oversight of screen-based trading systems for derivative products which identify areas of co-on regulatory concern. It is understood that individual jurisdictions will take account of differences in national legal standards, regulatory policies, and market customs or practice In addressing these concerns.

1. The system sponsor should be able to demonstrate to the relevant regulatory authorities that the system meets and continues to meet applicable legal standards, regulatory policies, and/or market custom or practice where relevant.

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1. For purposes of these principles, the term "derivative products" refer to those products in which the exchange or market itself is the issuer which are subject to the rule of the issuing market, and for which a clearing organization is used to settle profits and losses, make deliveries, and guarantee cleared trades.
    2. The principles set out in broad terms regulatory considerations arising from cross-border screen-based trading, and not the specific concerns of some members in respect of the particular laws applying to their jurisdiction (e.g., those dealing with anti-competitive rules and practices, margin levels, or capital requirements).
  2. The system should be designed to ensure the equitable availability of accurate and timely trade and quotation information to all system participants and the systems sponsor should be able to describe to the relevant regulatory authorities the processing, prioritization, and display of quotations within the system.

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3. The system sponsor should be able to describe to the relevant regulatory authorities the order execution algorithm used by the system *i.e.* the set of rules governing the processing, including prioritization, and execution of orders.
  4. For a technical perspective, the system should be designed to operate in a manner which is equitable to all market participants and any differences in treatment among classes of participants should be identified.
  5. Before implementation, and on a periodic basis thereafter, the system and system interfaces should be subject to an objective risk assessment to identify vulnerabilities (*e.g.*, the risk of unauthorized access, internal failures, human errors, attacks, and natural catastrophes) which may exist in system design development, or implementation.
  6. Procedures should be established to ensure the competence, integrity, and authority of system users, to ensure that system users are adequately supervised, and that access to the system is not arbitrarily or discriminatorily denied.
  7. The relevant regulatory authorities and the system sponsor should consider any additional risk management exposures pertinent to the system including those arising from interaction with related financial systems.
  8. Mechanisms should be in place to ensure that the information necessary to conduct adequate surveillance of the system for supervisory and enforcement purposes is available to the system sponsor and the relevant regulatory authorities on a periodic basis.
  9. The relevant regulatory authorities and/or the system sponsor should ensure that the system users and system customers are adequately informed of the significant risks particular to trading through the system. The liability of the system sponsor, and/or the system providers to system users and system customers should be described, especially any agreements that seek to vary the allocation of losses that otherwise would result by operation of law.
  10. Procedures should be developed to ensure that the system sponsor, system providers, and system users are aware of and will be responsive to the directives and concerns of relevant regulatory authorities.

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**APPENDIX B      List of Acronyms**

AP	Associated Person
BAWe	Bundesaufsichtsamt für den Wertpapierhandel (Federal Securities Supervisory Office)
BTCC	Board of Trade Clearing Corp. (USA)
CAD	European Community Capital Adequacy Directive
CEA	Commodity Exchange Act (USA)
CFTC	Commodities Futures Trading Commission (USA)
CM	Clearing Member
CME	Chicago Mercantile Exchange
CMR	Client Money Regulation (UK)
CRR	counterparty risk requirement
DCM	Direct Clearing Member
DKV	Deutscher Kassenverein AG
DTB	Deutsche Terminbörse (German Options and Futures Exchange)
FCM	Futures Commission Merchant
FIA	The Futures Industry Act 1993 (Malaysia)
FIR	Futures Industry Regulations 1995 (Malaysia)
FSA	Financial Services Act (UK)
FSA	The Financial Supervisory Authority (Sweden)
FTPA	The Futures Trading Practices Act of 1992 (USA)
GCM	General Clearing Member
HKCC	HKFE Clearing Corporation Ltd.
HKFE	Hong Kong Futures Exchange Ltd.
ILOC	Irrevocable Standby Letter Of Credit
ISE	Investment Services Enterprise (Germany)
KLCE	Kuala Lumpur Commodity Exchange
KLOFFE	Kuala Lumpur Options and Financial Futures Exchange
LOC	letter of credit
MDCH	Malaysian Derivatives Clearing House
MFCC	Malaysian Futures Clearing Corporation
MIOER	Market Index Option Escrow Receipt
MME	Malaysia Monetary Exchange
NCFE	National Commodity Futures Examination (USA)
NCM	Non-Clearing Member
NFA	National Futures Association (USA)
NSE	National Stock Exchange of India Ltd.
NZSC	New Zealand Securities Commission
NZFOE	New Zealand Futures and Options Exchange
OCC	Option Clearing Corporation (USA)
ODD	Option Disclosure Document (USA)
OM	Options Market (Sweden)
OTC	over-the-counter
PRR	position risk requirement
SC	Securities Commission (Malaysia)
SEBI	Securities Exchange Board of India

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SEC	Securities and Exchange Commission
SEHK	Stock Exchange of Hong Kong Ltd.
SEOCH	Stock Exchange of Hong Kong Options Clearing House Ltd.
SFA	The Securities and Futures Authority Ltd. (UK)
SFC	Securities and Futures Commission (Hong Kong)
SIB	The Securities and Investment Board (UK)
SRO	Self Regulatory Organisation
TIMS	Theoretical Intermarket Margin System
WpHG	Securities Trading Act (Germany)