



Management, Supervision, and Internal Control Standards for entities licensed by the Capital Markets Authority (CMA)

Introduction and regulatory objective of the Standards

The Internal Control Standards has been developed by CMA in accordance with section 11(3) (e), (f) and (w) of the Capital Markets Act to ensure the proper conduct of a licensed or an approved business and-

1. to ensure, on a continuous basis and on a timetable determined by CMA, that licensed entities which are members of a Self Regulatory Organization (SRO) (exchange or a clearing house) or other entities undertaking licensed activities, are complying with the applicable laws, rules and regulations and that such compliance provides assurance of-
 - a) the ability to carry on the business in an orderly and efficient manner;
 - b) safeguarding its assets and assets of its clients;
 - c) maintenance of proper records and the reliability of financial and other information used within and published by the business;
 - d) compliance with all applicable laws and regulatory requirements; and
 - e) the completeness and competency of the compliance function of the firm;
2. to achieve an appropriate level of comfort that a licensed person is in compliance with the requirements of CMA and will utilise a variety of resources and tools, including assessment questionnaires submitted to licensed entities as well as on site and off site inspections either by CMA staff or by third parties instructed by CMA. Third Party inspections may include those by Self-Regulatory Organisations (SROs) and compliance teams or independent accounting or legal firms instructed by CMA.

Review Process

1. The review process will entail gaining an understanding of securities related businesses and organizational structure of the firm. CMA may consider the following in the process of review-

- a) What is the board and senior management involvement in compliance setting and monitoring?
- b) What is the tone from the top?

Do they promote a strong and proactive culture of compliance in the firm in setting overall compliance policy?

- Do they recognize the high priority of compliance and actively work with senior compliance officers?

- c) Evaluating how the firm fulfils its compliance responsibilities

- The independent oversight of compliance by the firm and its employees; and compliance functions including-

- coverage;
- resources;
- systems; and
- communications with the board and senior management

- experience and independence of personnel with compliance responsibility;

- a review of employee supervision including-

- hiring;
- registration;
- licensing;
- continuing education;
- personal trading; and
- training.

- d) a review of the supervisory structure ;

- e) written supervisory procedures including-

- front line supervision, and
- branch office supervision;

- f) an evaluation of how the firm identifies and addresses compliance risks including how it assesses its own compliance program including-

- branch examinations;
- audits;
- new product reviews;
- surveillance; and
- attitude to whistle-blowing;

g) a risk management review which looks to ensure that risk (credit, market, legal and operational risks) is-

- identified;
- assessed;
- monitored; and
- controlled within the licensed firm.

2. There is no standardized blueprint for assuring compliance within a licensed firm and compliance may be accomplished through a centralized department or dispersed among various control units.
3. The design and implementation of compliance system of a firm must take into account factors such as size and geographic dispersion, types of business activities, products offered and customers of the firm, operations and technology, legal and regulatory issues, market conditions, and other relevant factors.
4. Compliance must be viewed as constantly evolving - as the environment changes, or as better practices come to light, firms should change their compliance systems accordingly to maintain the highest level of appropriate compliance controls.
5. In addition to considering the internal controls, systems and the risk management controls deployed by the firm, CMA will supplement such reviews by assessing, as necessary,-

- **Business Matters –**

- has the member entered new lines of business, developed significant new customers or modified its investment practices or strategies?
- has the member hired any new professionals whose activities should be covered by the compliance program?
- has the member implemented new software or automation initiatives?
- has the member's ownership changed (as a result of a sale of the business or merger?) Has the member acquired any new subsidiaries?
- has there been any other business or organizational changes?

- **Industry Developments –**

- has there been any change in industry “best practices” or other standards?
- has another relevant regulator proposed or adopted any rules relating to the business of the member?

- **Complaints and Compliance Exceptions-**

- is there a pattern of client complaints or compliance exceptions?

- were remedial actions taken promptly?
- is there a pattern in the remedial actions taken?
- were complaints or exceptions escalated properly?

- **Problems with the Compliance Program –**

- has there been any issue with interpretation or confusion about the application of specific policies and procedures?
- has there been any compliance concern not anticipated by the compliance program or violations of specific policies and procedures for which a remedial process was not identified?
- has there been any problem in enforcing the compliance program (for example difficulties with respect to specific individuals or matters)?

Capital Markets Authority
Management, Supervision and Internal Control Standards

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Management, Supervision and Internal Control Standards

The attached Standards have been compiled to assist licensed persons understand what is expected of them to meet the required level of internal control. The Standards indicates the manner in which, in the absence of any particular consideration or circumstances, CMA proposes to perform its function of ensuring that all licensed or registered persons are fit and proper in relation to the manner in which they conduct the regulated activities for which they are licensed or registered.

A pragmatic approach will be adopted taking into account all relevant circumstances, for example the inability of a small firm to segregate duties. CMA staff will also take into account whether there are compensatory management and supervisory measures implemented by the management. The Internal Control Standards relates to the manner in which a licensed or a registered person structures, manages and operates the respective regulated activities for which that person is licensed or registered and in particular, the existence of a satisfactory internal control and internal management systems.

It is noted that a number of the key internal control practices and processes that these Standards cover have been specifically included in the Capital Markets (Conduct of Business) (Market Intermediaries) Regulations, 2011, in particular-

- know your client principles;
- best client execution and other dealing practices;
- insider trading;
- conflicts of Interest;
- segregation and protection of client assets;
- record keeping, accounting and audit requirements; and
- timely submission of financial statements and returns to the CMA.

In the period between 2008 and 2010, a number of firms were made the subject of statutory management by CMA and three risks were found to be prevalent amongst these failed operations which were clearly the responsibility of the board of directors of the firms. These were-

a) Regulatory risk

This is the risk of non-compliance with regulatory requirements. This is a prospective risk to earnings or capital arising (due to fines) from violations or non-compliance with laws and regulations including standards issued by the Authority from time to time.

b) Strategic risk

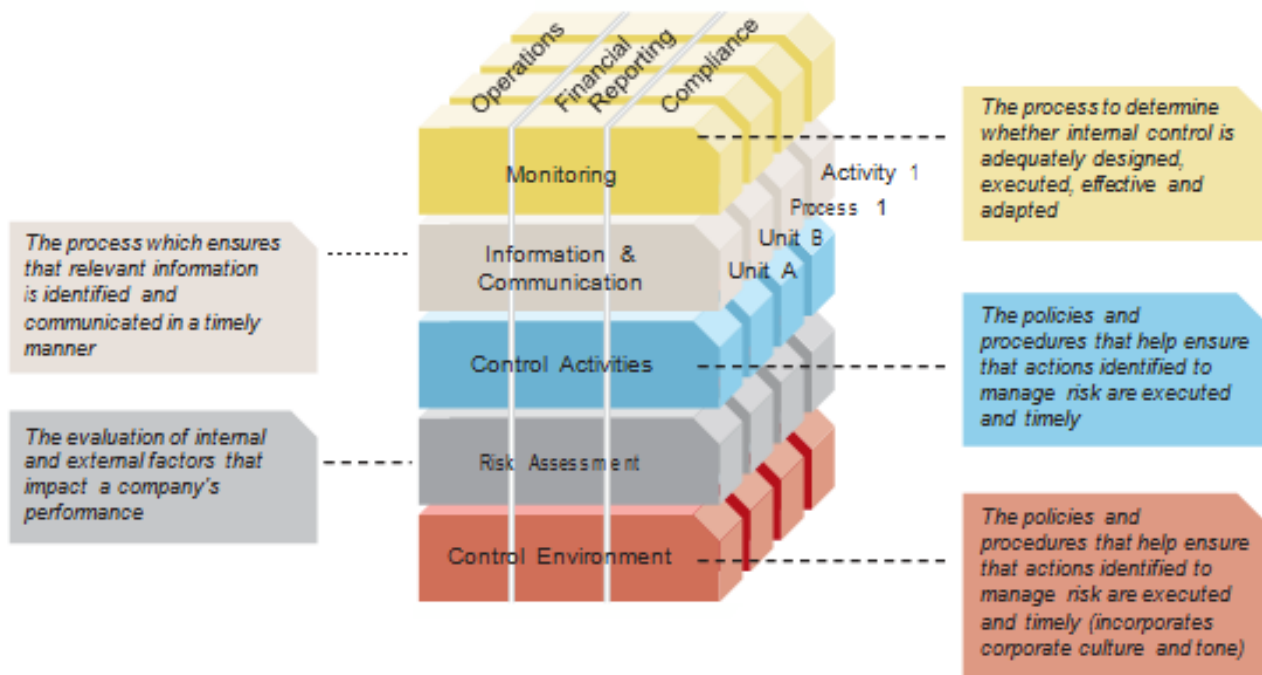
This is the risk arising from adverse business decisions, improper implementation of decisions or lack of responsiveness to industry changes.

c) Reputational risk

This is the potential that negative publicity regarding the business practices of a firm whether true or not will cause a decline in the customer base, revenue reduction or could lead to costly litigation. This may result from an institution's inability to effectively manage any or all of the other risks.

It is incumbent on the board of directors of a licensed firm to ensure that proper internal controls and risk management practices are in existence and the governance standards of the board of directors are sufficient to limit failures due to regulatory, strategic and reputational risk.

The following are the layers of control for board oversight-



A sample control guide for the board would be a formal assessment of the overall controls of the firm as follows-

Criteria	Specific Controls Identified (example issues to raise to identify controls)	How controls evaluated?	Board's Assessment of Controls 1-
Control Environment and Control Activities	<ol style="list-style-type: none"> 1. Are the directors and management committed to leadership by example? 2. Is the organisational structure defined clearly such that employees know what is expected of them and so as to ensure that decisions are made and actions taken by the appropriate people? 3. Has the board established clear strategies for addressing the significant risks that have been identified? 4. Have policies been established on how to manage these risks? 5. Do employees have the knowledge, skills and tools to support the achievement of the company's objectives and to effectively manage its risks? 6. Are controls adjusted as new risks or operational deficiencies are identified? 7. Is there a professional approach to financial 	(e.g. internal audit - date)	
Risk Assessment	<ol style="list-style-type: none"> 1. Are the company's objectives clear? 2. Are significant operations, financial and compliance risks assessed on an ongoing basis? 3. Are the risks which are acceptable to the board clearly understood by management and employees? 		
Information and communication	<ol style="list-style-type: none"> 1. Are management and the board provided with ongoing, up-to-date, relevant and reliable financial and other information on the company's progress against its business objectives in order to identify developments which require its intervention? 2. Do business continuity/disaster recovery plans exist for IT monitoring and reporting systems? 3. Is there an established system of communication for individuals to report suspected breaches of laws or regulations? 		

Monitoring Controls	<ol style="list-style-type: none"> 1. Are there established processes to provide the board with ongoing assurance that there are appropriate control procedures in place for the company/group's financially significant business activities, and that these procedures are being followed? 2. Are changes in the business or its environment which may require changes to the system of internal control identified? 3. And are there procedures to ensure that appropriate corrective action is taken in response to the risk and control assessments? 4. Is there communication to the board on the effectiveness of ongoing monitoring? 		
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I. MANAGEMENT AND SUPERVISION

OBJECTIVE

To ensure that an effective management and organisational structure, which ensures the operations of the business are conducted in a sound, efficient and effective manner is established, documented and maintained.

Control Standards

1. The Management shall assume full responsibility for the operations of the firm including the development, implementation and on-going effectiveness of the internal controls of the firm and the adherence thereto by its directors and employees.
2. The Management shall ensure that regular and effective communication occurs within the firm to ensure that the Management is continually and timely apprised of the status of the operations and financial position of the firm, including qualitative and quantitative risks posed thereto or weaknesses detected therein, non-compliance with legal and regulatory requirements and the overall adherence to the defined business objectives of the firm.
3. The Management shall ensure that reporting lines are clearly identified with supervisory and reporting responsibilities assigned to the appropriate staff member(s).
4. The Management shall ensure that detailed policies and procedures pertaining to authorisations and approvals, as well as the authority of key positions are clearly defined and communicated to and adhered to, by staff.
5. The Management shall ensure that the management and supervisory functions of the firm are performed by qualified and experienced individuals.

II. SEGREGATION OF DUTIES AND FUNCTIONS

OBJECTIVE

To ensure that key duties and functions are appropriately segregated, particularly those duties and functions which when performed by the same individual may result in undetected errors or may be susceptible to abuses which may expose the firm or its clients to inappropriate risks.

Control Standards

1. The Management shall ensure that, where practicable, policy formulation, supervisory and other internal review or advisory functions, including, where applicable, compliance and internal audit, are effectively segregated from line operational duties. Such segregation serves

to ensure the effectiveness of supervisory and other internal controls established by the Management.

2. The Management shall ensure that operational functions including, but not limited to, sales, dealing, accounting and settlement are, where practicable, effectively segregated to minimize the potential for conflicts, errors or abuses which may expose the firm or its clients to inappropriate risks. The Management should ensure that special care is taken to ensure that the sales and dealing functions are segregated from the research function where possibility of potential conflict of interest exists. Where practicable, the research and the corporate finance functions should be segregated to ensure the objectivity of the research function.
3. The Management shall ensure that the compliance and internal audit functions should be effectively segregated and independent from the operational and related supervisory functions, and report directly to the Board.

III. PERSONNEL AND TRAINING

OBJECTIVE

To ensure that appropriate personnel recruitment and training policies are established with adequate consideration given to training needs to ensure compliance with the operational, internal control policies and procedures of the firm, and all applicable legal and regulatory requirements to which the firm and its employees are subject to.

Control Standards

1. The Management shall implement procedures to ensure that the firm employs persons who are fit and proper to perform the duties for which they are employed and that such persons are duly registered with all applicable regulatory bodies as required.
2. The management shall ensure that all staff and other persons performing services on behalf of the firm are provided with adequate and up-to-date documentation regarding the policies and procedures of the firm which should include those relating to internal controls and personal dealing.
3. The Management shall ensure that adequate training suitable for specific duties which staff member(s) perform is provided both initially and on an ongoing basis. A training programme of the firm should ensure that staff possesses or acquires appropriate and practical experience through "on-the-job" training and where appropriate, structured courses.

IV. INFORMATION MANAGEMENT

OBJECTIVE

To ensure that policies and procedures are established to ensure integrity, security, availability, reliability and thoroughness of all information, including documentation and electronically stored data, relevant to the business operations of the firm.

Control Standards

1. The Management shall ensure that the management of information, both in physical and electronic form, is assigned to a qualified and experienced staff member(s).
2. The Management shall ensure that the operating and information management systems of the firm (including electronic data processing ("EDP") systems) meet the needs of the firm and operate in a secure and adequately controlled environment.
3. The Management shall ensure that information management reporting requirements are clearly defined to ensure the adequacy and timeliness of production of required internal and external reports including those required by relevant regulatory and self-regulatory bodies.
4. The management shall ensure that key components of the information management system design and implementation programme are adequately documented and regularly reviewed for effectiveness.
5. The Management shall ensure that appropriate and effective EDP and data security policies and procedures are implemented to prevent and detect the occurrence of errors, omissions or unauthorised insertion, alteration or deletion of, or intrusion into, the data processing system of the firm (electronic or otherwise) and data (covering all confidential information in the possession of the firm, such as clients' personal and financial information and price sensitive information).
6. The Management shall establish and maintain effective record retention policies which ensure that all relevant legal and regulatory requirements are complied with, and which enable the firm, its auditors and other interested parties, for example exchanges, clearing houses and the Authority to carry out routine and *ad hoc* comprehensive reviews or investigations.

V. COMPLIANCE

OBJECTIVE

To ensure that policies and procedures are established and maintained to ensure compliance of the firm with all applicable legal and regulatory requirements as well as with the internal policies and procedures of the firm.

Control Standards

1. The Management shall establish and maintain an appropriate and effective compliance function within the firm which, subject to constraint of size, is independent of all operational and business functions, and which reports directly to Management.
2. The Management shall ensure that staff performing the compliance function possesses the necessary skills, qualifications and experience to enable them to effectively execute their duties.
3. The Management shall establish and enforce clear policies to ensure that the compliance function covers all relevant aspects of the firm's operations, including the unfettered access to necessary records and documentation.
4. The Management, in conjunction with the staff performing the compliance function, shall establish, maintain and enforce effective compliance procedures. These procedures should cover legal and regulatory requirements including where applicable registration or licensing and financial resources requirements; record keeping (for management and regulatory reporting, audit and investigations); business practices (for example codes of conduct; commission rebates and "soft dollar"¹ practices; and preparation, approval and dissemination of research reports); prevention of money laundering; internal control matters; and compliance with the relevant client, proprietary and staff dealing requirements.
5. The Management shall establish, maintain and enforce policies and procedures to ensure the proper handling of complaints from clients and that appropriate remedial action is promptly taken. The complaints procedures should be in writing. Where possible, complaints should be investigated by staff members performing the compliance function, who are not directly involved in the subject matter of the complaint.
6. Staff performing the compliance function shall promptly report to the Management all occurrences of material non-compliance by the firm or its staff with legal and regulatory requirements, as well as with policies and procedures of the firm. The Management should promptly notify the applicable exchanges, clearing houses and the Authority of occurrences of material non-compliance by the firm or its staff with relevant legal and regulatory requirements.

VI. AUDIT

OBJECTIVE

To ensure that an audit policy and related review function² which objectively examines, evaluates and reports on the adequacy, effectiveness and efficiency of the management, operations and internal controls of the firm is established and maintained.

¹ "Soft Dollar" practices refer to the payment "in kind" for directing business to a brokerage, for example providing fund managers with data vendor terminal services or paying for hotel and travel costs of a client to attract brokerage business.

²The review functions may be performed by any staff or external consultations (such as external auditors) meeting the skills, experience and qualification criteria. This is to be distinguished from statutory audit work which may provide limited comfort as to the firm's supervision and internal control systems. Where practicable, the review function should be overseen by an audit committee of the firm.

Control Standards

1. Where practicable, the Board of the firm shall establish an independent and objective internal audit function which is free of operating responsibilities. This function should have a direct line of communication to the audit committee and the Board .
2. The Board shall develop clearly prescribed terms of reference which sets out the scope, objectives, approach and reporting requirements for the external audit functions and where applicable, the internal audit functions. The relative roles, responsibilities and the working relationship between internal and external auditors should be clearly defined.
3. The Board shall ensure that the person(s) performing the review function possesses the necessary technical competence and experience.
4. The Board shall ensure that there is adequate planning, control and recording of all audit and review work performed; timely reporting of findings, conclusions and recommendations to Board; and matters or risks highlighted in the relevant reports are followed up and resolved satisfactorily.

VII. OPERATIONAL CONTROLS

OBJECTIVE

To ensure that effective policies and operational procedures and controls in relation to the day-to-day business operations of the firm are established, maintained and complied with. The effectiveness of such operational procedures and controls shall be evaluated to ensure-

- a) an adequate exchange of information between the firm and its clients including information from and required disclosures of information to clients;
- b) the integrity of the dealing practices of the firm including the treatment of all clients in a fair, honest and professional manner;
- c) the safeguarding of both the assets of the firm and assets of its clients;
- d) the maintenance of proper records and the reliability of the information contained therein and used within the firm or used for publication; and
- e) the compliance by the firm and persons acting on the firm's behalf, with relevant legal and regulatory requirements.

Control Standards

1. The Management shall establish and maintain processes to obtain and confirm information regarding every client in relation to establishing the true identity of the client through the proper application of “know your client” principles, the beneficial owner(s) and person(s)

authorised to give instructions; and the client's financial position, and investment experience and objectives prior to the establishment of an account.

2. Where the firm exercises discretionary authority over a client's account, the procedures are used to ensure that the precise terms and conditions under which such authority may be exercised are effectively communicated to the client, and that only transactions which are consistent with the investment strategies and objectives of the relevant client, are effected on the client's behalf. The use of nominee accounts should be restricted to client activity and not used to mask house, Directors or staff trading.
3. Where the firm is in the business of offering investment advice for remuneration, or has entered into a contractual advisory arrangement with a client, and in the course of such business gives investment recommendations or advice, measures and procedures are adopted to ensure that such recommendations and advice are based on thorough analysis, taking into account available alternatives and that such recommendations and advice are appropriate for the relevant client. The firm should document and retain the reasons for the recommendations and advice given.
4. The firm shall establish specific policies and procedures to minimize the potential existence of conflicts of interest between the firm or its staff and clients, and further, in circumstances where actual or apparent conflicts of interest cannot reasonably be avoided, that clients are fully informed of the nature and possible ramifications of such conflicts and are treated fairly in all cases.
5. The Management shall establish and maintain policies and procedures which ensure that whenever the firm or its staff member(s) have a material interest in a transaction with a client, the interest is disclosed, where practicable, to the client prior to the execution of the relevant transaction.
6. The Management shall establish and maintain policies and procedures which ensure that orders made by a client are handled in a fair and equitable manner and, in all cases comply with order handling requirements specified in various codes or regulations. In particular, clear and comprehensive audit trails are created to precisely record all orders (both client and internally generated) from the time of origination, including the time the order was received or initiated, through order execution and settlement, for example through use of sequential numbering on order tickets and the use of time stamping facilities.
7. The Management shall establish and enforce procedures which ensures that proper safeguards exist to prevent the firm or its staff from taking advantage of confidential price sensitive information, or executes transactions as or on behalf of insiders which may contravene any laws.
8. The Management shall establish and maintain appropriate and effective procedures in relation to dealing and related review processes to prevent or detect errors, omissions, fraud and other unauthorised or improper activities, which ensures fair and timely allocation of trades are effected on behalf of clients.
9. The Management shall ensure that appropriate and effective procedures are established and complied with to protect both the assets of the firm and those of its clients from theft, fraud and other acts of misappropriation. In particular, the authority of the firm and its staff to acquire,

dispose of and otherwise move or utilise the assets of the firm or those of its clients is clearly defined and adhered to. All assets shall be properly safeguarded while at the premises of the firm and should be promptly deposited into appropriate accounts at banks or securities depositories. The Management shall also ensure that adequate and reliable audit trails are maintained to enable the firm to prevent, detect and investigate suspected improprieties.

10. The Management shall ensure that regular reconciliation of internal records of the firm and reports issued by third parties, for example clearing houses, banks, custodians, counterparties and executing brokers are undertaken to identify and highlight for action any errors, omissions or misplacement of assets, and such reconciliations are checked or reviewed and approved by appropriate senior staff member(s).

VIII. RISK MANAGEMENT

OBJECTIVE

To ensure that effective policies and procedures are established and maintained to ensure the proper management of risks to which the firm and, if applicable, its clients are exposed, particularly with regard to their identification and quantification, whether financial or otherwise, and the provision of timely and adequate information to Management to enable it to take appropriate and timely action to contain and otherwise adequately manage such risks.

Control Standards

1. The Management shall ensure that appropriate and effective risk management policies are established and monitored by a risk management function which, depending upon the circumstances of the firm consist of a sufficient number of suitably qualified and experienced professionals.
2. The Management shall ensure that appropriate and effective procedures are established and followed to ensure that the firm's risks of suffering loss, financial or otherwise, as a consequence of client defaults or changing market conditions are maintained at acceptable and appropriate levels. In all events, the procedures should ensure that the firm only takes positions which it has the financial and management capacity to assume.
3. Where the firm carries out proprietary trading, appropriate trading limits and position limits are established and monitored at appropriate intervals depending on the level of activity and reviewed as part of the end-of-day processing routine. Applicable trading limits, position limits and other risk management measures should be checked and reviewed for effectiveness on a timely basis.
4. The Management shall ensure that comprehensive reviews are conducted at suitable intervals, and wherever there is significant change in the business, operation or key personnel, to ensure that the firm's risk of suffering losses, whether financial or otherwise, as a result of fraud, errors and omissions, interruptions or other operational or control failures is maintained at acceptable and appropriate levels.

5. Appropriate exposure reports are submitted regularly to the Management and any significant variances are reported promptly to the Management.
6. The Management shall clearly define its risk policies and shall establish and maintain risk measurements and reporting methodologies commensurate with its business strategies, size, complexity of its operations and risk profile.

APPENDIX

SUGGESTED CONTROL TECHNIQUES AND PROCEDURES

In this Appendix, details of various internal control techniques and procedures commonly implemented by licensed/registered persons in the financial industry are provided. These techniques and procedures neither constitute nor should be construed as an exhaustive or comprehensive list of applicable or relevant internal control techniques and procedures. They represent suggested approaches, which when employed effectively, can serve to assist licensed/registered persons in establishing sound internal control systems and enhance their ability to comply with relevant legal and regulatory requirements. Each licensed/registered person, however, must consider carefully the specific nature and particular needs of their business when designing and implementing an internal control system.

The control techniques and procedures described in this Appendix relate to the areas of Operational Controls and Risk Management set forth in Parts VII and VIII respectively of the "Management, Supervision and Internal Control Standards". Greater detail with respect to these areas is deemed appropriate in as much as they tend to be generally applicable to most licensed/registered persons. Adoption of some or all of the suggested internal control techniques and procedures contained in this Appendix is neither a necessary condition nor a guarantee that a firm's internal controls are satisfactory.

A. Operational Controls

Opening and handling of client accounts

1. Mandatory account opening procedures are clearly defined and followed. Such procedures may include:
 - a) recording and retention for future reference of all relevant client information (such as the true identities of the client, the beneficial owner(s) and representatives who are authorised to issue instructions, as well as the financial position and investment experience and objectives of the client), related specimen signatures, and supporting documentation;
 - b) reviewing and confirming client information gathered, using criteria approved by the Management;
 - c) ensuring that the client is provided with adequate information about the firm and the services to be provided to the client, together with other relevant documents such as relevant risk disclosure statements (particularly where the firm possesses discretionary authority over the account or where derivative financial products will be transacted on the client's behalf), and the nature and scope of fees, penalties and other charges the firm may levy;

- d) ensuring that the client is provided with adequate information regarding his rights including if applicable, coverage under one of the investor compensation fund arrangements;
 - e) procuring execution of applicable client account agreements as required under relevant law, rules, regulations and codes; and
 - f) reviewing and approving new account applications and amendments to existing accounts, along with related supporting documentation, by designated staff.
2. In the case of discretionary accounts, special procedures are implemented and followed which may include-
- a) executing a discretionary account agreement which sets out the investment objectives and strategies of the client and the precise terms and conditions under which such discretion will be exercised;
 - b) regular reviews of the performance of the account conducted by designated staff member(s) independent of the staff handling the account;
 - c) providing the client with regular statements and timely *ad hoc* reports on account balance and transaction details, especially when the account balance falls below agreed levels or when large orders for the account are pending or executed; and
 - d) clearly delineating the investment decision making process from the dealing process: order tickets similar to those used for non-discretionary agency business are completed and time-stamped to record the actual time the orders are initiated.

Providing investment advice

3. Where the firm is in the business of offering investment advice for remuneration, or has entered into a contractual advisory arrangement with a client, and in the course of such business, gives investment recommendations or advice, special procedures are implemented and followed which may include-
- a) establishing clear requirements and procedures regarding adequacy of research work and preparation and retention of documentation supporting the recommendations and advice;
 - b) providing to the client in writing details of the fees, charges and penalties applicable to the recommended investment scheme; and
 - c) documenting (and providing a copy to the client) the rationale underlying investment advice rendered or recommendations made. Such advice and recommendations must be suitable taking into account the client's particular investment experience, objectives and financial position.

Dealing practices

4. The firm puts in place procedures to ensure that its staff's trading activities are not prejudicial to the interests of its clients. Staff members are required to disclose to the firm, on joining and regularly afterwards (at least semi-annually), details of holdings and trading activities in which they have an interest in relation to specific securities, futures and other investment products in which the firm deals in or in respect of which the firm acts as an investment adviser or commodity trading adviser. Staff members of a firm which is, or belongs to a group within which a group member is, a member of an exchange are required to trade through staff accounts in relation to products traded on that exchange. All transactions for staff accounts must be separately recorded and diligently monitored by independent senior management.
5. The firm clearly defines parameters in relation to the acceptance by staff member(s) or the firm of gifts, rebates, benefits-in-kind or "soft-dollar" benefits received from clients or other business contacts. These include the circumstances under which acceptance is permitted and approval required.
6. Effective procedures are established to ensure that whenever the firm or its staff member(s) have an interest in a transaction with a client (i.e. a direct/cross transaction), this fact is disclosed to the client prior to the execution of the relevant transaction. For example, the firm may maintain a register of direct and cross trades which also records the name of the client and the firm account involved, the person contacted and the time when the consent was received. The register is reviewed regularly (at least monthly) by designated staff member(s) performing the compliance function or a senior staff member in the dealing department.
7. Order handling procedures are clearly documented and followed. Such procedures may include-
 - a) Orders are recorded, using standard order forms, and time-stamped promptly upon initiation or receipt and are required to be transmitted to the dealer, floor trader or operators of terminals for automated trading systems within a reasonable time period, normally immediately. This applies to both agency orders and internally generated orders (e.g. orders for the proprietary accounts, staff accounts, funds managed by the firm and working orders³). This recording procedure may be modified to take into account the different types of orders in different markets so long as it provides an audit trail.
 - b) Prior to executing a client order, the following items are checked by designated staff:-
 - i. the status of the account (active, closed or being on an internal watch list, etc.);
 - ii. applicable account limits, if any (for example trade, position, credit);
 - iii. the sufficiency of available funds or available credit in the relevant account;

³“Working orders” are orders generated internally by the firm to facilitate the execution of large orders or special client orders which give the dealer discretionary authority to decide the timing of putting the order or “component” orders to the market and the size of each order.

- iv. in the case of a sell order, the sufficiency and availability of securities or the existence of necessary securities borrowing arrangements, if applicable;
 - v. the authority and applicable limitations thereon of the person placing the order;
 - vi. where the order is received by facsimile or telex, such order is reviewed by senior staff and, if in doubt, the client is called to check the validity and authority of the order prior to execution;
 - vii. the services and products the account is authorised to use/trade; and
 - viii. any special conditions stated in the client agreement or reported by other operating departments within the firm, for example margin position.
- c) Clearly defined policies and procedures are followed regarding the permitted circumstances under which a client order is not required to be immediately exposed to the applicable market for execution (for example, stop loss orders, orders which give the dealer discretionary authority to decide the timing of putting "component" working orders to the market and the size of each working order). Such procedures may include the method used to determine the acceptable price(s) at which a transaction or part transaction(s) may be executed.
- d) Management should establish criteria to cover the review of orders upon receipt or initiation to determine the execution methodology and timing of execution for each order. Clear audit trails indicating the time of transmission and reference to the originating order should be maintained.
- e) Effective procedures regarding the transmission of orders to the dealing room are established. Sufficient information should be given to enable client priority to be established.
- f) Where practicable, a designated senior staff member who is independent of the traders should be assigned to allocate trades executed in accordance with the client priority and sequence of order receipt.

Chinese wall

- 8. The firm avoids apparent and potential conflicts of interest by establishing and maintaining adequate "Chinese Walls", such as the separation of dealers handling client funds or discretionary orders from those handling proprietary or staff accounts.
- 9. Management establishes and maintains policies and procedures regarding "Chinese Walls" to ensure that price-sensitive information privy to the research staff or staff handling corporate finance matters like a takeover and merger should not be available to staff outside those departments, except on a "need to know" basis.

Back office and accounting

10. Transaction/Order forms are transmitted to the designated back office staff member(s) who enter the details into the firm's own in-house system (whether automated or otherwise). At the end of each business day, the firm's own record of trades is matched by the back office staff to the trading/clearing lists received from the exchanges or clearing houses and where applicable, to confirmation documents issued by counterparties and executing brokers. Exception reports identifying mis-matched and unusual trades are produced, reviewed and follow-up actions taken, where necessary.
11. All trades are confirmed promptly with the client on whose behalf the trade was executed and, for off-exchange trades, these are also confirmed promptly with the counterparty using reliable and pre-agreed methods such as SWIFT or tested telex.
12. All trade errors are reported to the person responsible for dealing and are allocated to an "error" or "suspense" account for prompt correction or closure of the position. The transactions in this account should be supported by clear documentation explaining the relevant circumstances and reviewed by the staff member(s) performing the compliance and internal audit functions. Any unusual circumstances or patterns should be investigated.

Asset protection

13. Effective procedures are established and followed, when handling movements of firm and client assets. Such procedures may include-
 - a) Clearly identifying staff member(s) and representatives of clients (for client assets) with authority to acquire, dispose of, lend, pledge or otherwise part with possession of, firm and client assets, and the parameters of such authority. The authority is checked with respect to each asset movement and client withdrawal request.
 - b) Use of standardised and sequentially numbered receipts and despatch notes or other appropriate methods to acknowledge and account for asset movements.
 - c) Securely storing firm and client assets, other important documents and controlled forms such as cheque books, contract notes etc., while at the firm's premises; and promptly depositing cheques, cashier orders and other negotiable instruments and securities into the appropriate account(s) at banks or securities depositories. During the period that physical scrip or cash is held at the firm's premises, routine counts are conducted to ensure proper safeguarding of firm and client assets.
 - d) Maintaining reliable and adequate audit trails which enable the firm to thoroughly investigate suspected improprieties.
14. Where applicable, payment cheques to clients are crossed "Account Payee Only" and are made payable to the beneficial owner of the account or an authorised representative in conformity with applicable written standing client instructions. Similarly, the firm requires its clients to make payments to the firm by crossed cheques payable only to the firm.
15. Third party cheques are discouraged but are only accepted after required approval(s) has been obtained from designated senior staff member(s).

16. A register is maintained and used to update client asset ledger accounts. The client asset ledger is used to prepare regular statements which are mailed directly to the client at the address recorded in the client information file; and for reconciliation with statements of asset holdings issued by third parties, such as the clearing houses, banks and custodians and, where applicable, confirmation documents provided by counterparties or executing brokers. Where applicable, clients are encouraged to open stock segregated accounts with Central Securities Depository through the firm so that they can receive statements of stock movements and monthly balances from Central Securities Depository direct.
17. Management establishes and maintains policies and procedures to ensure that clients' requests not to mail them regular statements in respect of their accounts are genuine requests and such requests are in writing duly signed by the clients and regularly (at least annually) reconfirmed by clients.
18. Where the firm is a participant in Central Securities Depository, management establishes and maintains policies and procedures to ensure tight control over access to the Central Securities Depository and that such operations are regularly reviewed by its internal or external auditors, or designated staff member(s) performing the compliance function, who, amongst other things, review key reports of Central Securities Depository activities.
19. Authorisation requirements and authorised cheque signatories and applicable authority parameters, are clearly defined and communicated to the relevant bank; e.g. consider the need to require two or more authorised signatures. Under no circumstances are the firm's cheques to be signed unless the date, specified payee and amount portions of the cheques are properly filled in.
20. Appropriate controls exist with respect to access to computer systems, facsimile transmission and telex devices, where such devices are used to transmit important information, e.g. funds transfer instructions, settlement instructions and trade confirmations. Clear policies regarding confidentiality of passwords are developed, e.g. passwords are regularly changed and relevant passwords disabled upon a staff member(s) leaving the firm.
21. Regular compliance reviews and audits are conducted to detect activities or conditions which may violate, or contribute to non-compliance by the firm and its staff with, legal and regulatory requirements, as well as with the firm's own policies and procedures.

B. Risk Management

Risk management policy and measurements

22. The firm's risk policies measurements and reporting methodologies are subject to regular review, particularly prior to the commencement of the firm's provision of new services or products, or

when there are significant changes to the products, services, or relevant legislation, rules or regulations that might impact the firm's risk exposure.

Credit risk

23. The firm establishes and maintains an effective credit rating system to evaluate client and counterparty creditworthiness. Clearly defined objective measures should be used to evaluate potential clients and determine/review the relevant credit ratings which are used to set appropriate credit limits for all clients, including existing clients. The ratings and applicable limits reflect, among other things:
 - a) the client's credit rating by reputable credit rating agencies, if any;
 - b) investment objectives, investment history, trading frequency and risk appetite;
 - c) past payment records and defaults, if any;
 - d) the client's capital base and the existence and amount of guarantees and by whom such guarantees are given, if any;
 - e) any known events which may have an adverse impact on the client's financial status, potential for default or accuracy of information stored regarding the client; and
 - f) where credit is extended to cover margin trading, appropriate haircuts are made to market value to establish the clients have adequate equity.
24. The staff performing risk management function utilises appropriate quantitative risk measurement methodologies to effectively calculate and monitor the firm's credit exposure in relation to clients, including: pre-settlement credit exposures (for example marking to market of outstanding trades) and settlement risk (for example exposure caused by timing differences between deliveries versus payment).
25. The staff performing risk management function ensures that credit risks posed by all clients belonging to the same group of companies are aggregated for purposes of measuring the firm's credit exposure. Particular attention is paid to netting arrangements which may serve to reduce the firm's exposure to credit risk. Care must be taken to ensure that credit exposures are netted only if supported by appropriate executed netting agreements, or other appropriate protections.
26. The staff performing risk management function specifies trading and position limits for each client based on their respective credit rating and trading needs. These limits are enforced.
27. The firm's margin policy and procedures are clearly defined, documented and enforced. Matters to be covered in such margin policy include-
 - a) the types of margin which may be called, the applicable margin rates and the method of calculating the margin;
 - b) the acceptable methods of margin payment and forms of collateral;

- c) the circumstances under which a client may be required to provide margin and additional margin, and the consequence of a failure to meet a margin call, including the actions which the firm may be entitled to take; and
- d) applicable escalation procedures where a client fails to meet successive margin calls.

Market risk

- 28. Management specifies authorised products and instruments the firm may deal in and enforces effective procedures to ensure compliance. Relevant control techniques may include regular review of the balance sheet and profit and loss accounts, and records of individual traders and trading members for unauthorised investments or transactions; and confirmation of outstanding transactions with the firm's trading partners.
- 29. The staff performing risk management function reviews and otherwise enforces on an on-going basis compliance with trading and position limits in relation to proprietary trading and open positions with respect to each authorised product the firm trades or invests in.
- 30. Management establishes and maintains effective risk management measures to quantify the impact on the firm (especially if it deals in derivative financial products) and, if applicable, its clients from changing market conditions. These measures should cover all risk elements associated with the products traded or services provided by the firm. Matters to be covered in such risk measures may include-
 - a) unspecified adverse market movements - using an appropriate value-at-risk or other methodology to estimate potential losses (this is particularly important for firms which take significant proprietary positions in derivative products);
 - b) individual market factors - measures the sensitivity of the firm's risk exposure to specific market risk factors e.g. interest rate yield curve shifting and changes in market volatility; and
 - c) stress testing - determining the effect of abnormal and significant changes in market conditions on the firm using various quantitative and qualitative variable assumptions.
- 31. To discourage the firm's dealers from engaging in unauthorised trading, risk adjusted performance measures are used, which may impact a dealer's remuneration where the dealer's activities expose the firm to especially high risks. Dealers who have exceeded in pre-approved limits are subject to appropriate action.

Liquidity risk

- 32. Management sets and enforces concentration limits with respect to particular products, markets and business counterparties, taking into account their respective liquidity profile and the firm's approved liquidity risk policies.

33. Measures of maturity mis-matches between sources and funding requirements and concentrations of individual products, markets and business counterparties, are established and regularly monitored.
34. Management establishes appropriate arrears and default procedures to alert staff member(s) responsible for liquidity management to potential problems and to provide them adequate time to take appropriate action to minimise the impact of client or counterparty liquidity problems.

Operational risk

35. Management regularly reviews the firm's operations to ensure that the firm's risk of losses, whether financial or otherwise, resulting from fraud, errors, omissions and other operational and compliance matters, are adequately managed. Operational matters covered may include-
 - a) physical and functional segregation of incompatible duties such as trade, settlement, risk management and accounting;
 - b) maintenance and timely production of proper and adequate accounting and other records, and the ability to detect fraud, errors, omissions and other non-compliance with external and internal requirements;
 - c) security and the reliability of accounting and other information, such as exception reports which should accurately highlight unusual activities and facilitate the detection of fraud, errors and significant trends; and
 - d) staffing adequacy including personnel with relevant and sufficient skills and experience to minimise the risk of loss due to the absence or departure of "key" staff member(s).
36. An effective business continuity plan appropriate to the size of the firm is implemented to ensure that the firm is protected from the risk of interruption to its business continuity. Key processes in this area include: a business impact study, identification of likely scenarios involving interruptions (for example break down in its data processing systems) and documentation and regular testing of the firm's disaster recovery plan.
37. The firm has adequate insurance cover for different types of exposures, including but not limited to, fidelity insurance and replacement of equipment and other business and data processing devices.

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