



Euronext Derivatives Markets

GUIDANCE ON DOCUMENTED PROCEDURES

Guidance on Documented Procedures

A Member is required to maintain an appropriate system of internal controls to ensure that it continuously complies with the requirements imposed by and pursuant to the Euronext Rules. As part of its system of internal controls, a Member is required to have internal procedures in place specific to its capacity on the Euronext Markets and which are both documented and updated on a regular basis. For the avoidance of doubt, the documented procedures should reflect, amongst other things, how specific functions / tasks are carried out by the Member's staff relevant to the business it undertakes on the Euronext Markets (e.g. in respect of the back office function, the procedures should cover how trade / position reconciliations are undertaken and by whom and by when).

This document seeks to provide guidance to applicants for Membership to one or more of the Euronext Derivative Markets on the Exchange's requirement for Members to have documented internal procedures and should be read in conjunction with the Euronext Rules and the NYSE Liffe Trading Procedures. Whilst this guidance is not exhaustive and will not necessarily cover the entire scope of the applicant's business, it does set out the primary areas that an applicant should cover when documenting its procedures.

The Euronext Rules are split into two Books, Book I and Book II. Book I of the Rules set out the harmonised provisions which apply to all Euronext markets. Book I is augmented by specific local rules for each market which are contained in Book II and which are tailored to meet national statutory and regulatory requirements. The same approach applies to the NYSE Liffe Trading Procedures, with a set of harmonised procedures (Part One) and specific local procedures, as set out in (Part Two). For ease of reference, the Euronext Rules and the NYSE Liffe Trading Procedures are available on the NYSE Euronext website at:

<http://www.euronext.com/tools/documentation/wide/documents-2399-EN.html>

This guidance note is split into three key areas, (1) risk management and front office, (2) back office and (3) compliance and account opening procedures. The fourth section of this document provides guidance for applicants who intend to trade deliverable contracts.

1.

Risk Management and Front Office

Rule 8106 (Rules, Book I) (Internal Controls) sets out, amongst other things, the minimum risk management requirements for Euronext Members (relevant extracts from Rule 8106 are set out below). When documenting its procedures for risk management, an applicant should as a minimum consider the following:

- the security arrangements in place to prevent unauthorised access to the trading systems
- the pre-trade risk filters that are in place and that they comply with Rule 8106/4
- how are the filters set
- who is authorised to set them
- how often they are reviewed and by whom
- who is authorised to change them
- what intra-day risk analysis is performed and how
- if there is an attempted breach of limits, who monitors this; how is it escalated and what action is taken
- what procedures are in place to gain access to the market in the event of a disaster type incident

And if carrying out client business

- how credit / counterparty risk is monitored
- whether there are any additional pre-trade filters for order-routing customers (It should be noted that Members should have complete control over the pre-trade risk management for order routed client business.)
- how they are set
- who is authorised to set them
- how often they are reviewed and by whom
- who is authorised to change them

Extracts Rule 8106 (Book I)

8106/3 A Member's internal controls shall include pre- and post-trade risk management controls which are appropriate to the nature, scale and complexity of the Member's business on the Relevant Euronext Market Undertaking. For the avoidance of doubt this means that, inter alia, a Member shall ensure that it has appropriate arrangements in place:

- (i) to vet orders prior to their submission to the Central Order Book, irrespective of whether such orders have been submitted manually or electronically (including via an Automated Order Routing System); and
- (ii) to monitor the positional and financial risks inherent in the business it conducts.

8106/4 In respect of arrangements put in place by a Member pursuant to Rule 8106/3, the Member must be able to demonstrate to Euronext that the following monitoring requirements have been incorporated in their systems:

- (i) position limits;
- (ii) user definitions (i.e. the ability to define the individual user(s));
- (iii) product definitions (i.e. the ability to restrict access to particular Admitted Financial Instruments or groups of Admitted Financial Instruments);
- (iv) maximum order size per user; and
- (v) either automatic order rejection when a limit is exceeded or the order being held subject to manual override by an appropriately authorised risk manager.

2.

Back Office

Members should have documented procedures which set out the various functions performed by the Member's back office; such procedures should include, amongst other things:

- how trade / position reconciliations and any position transfers are conducted, by whom and when
- how exceptions are identified and resolved, by whom and when
- monitoring of the error account and defaulted trades
- procedures to determine which positions are to be settled. Is the process manual or automated?

Specific to the London Market ("LIFFE"):

- Timing of the procedures in order to meet the open interest deadline as detailed in LIFFE Circular 90/81 issued on 4 October 1990.

Margin (specific to the London Market ("LIFFE"))

In general – relevant to all applicants:

- how clients who are on call are identified, by whom and when
- how margin calls are performed i.e. manually or automated
- procedures for authorising margin calls i.e. by a Senior member of staff

General Clearing Member ("GCM") / LCH.Clearnet Limited ("LCH") relationship:

- how often margin is calculated that it is called by LCH
- how margin is calculated i.e. is a "reasonableness" check performed or is the exact amount of margin calculated
- if applicable, procedures for depositing funds with the LCH for the purpose of covering margin

GCM / Non Clearing Member ("NCM") relationship:

- how margin is calculated and called from NCMs in line with LIFFE Rules (Book II, Rule 3.27), by whom and when
- if applicable, how credit is extended to NCMs in line with the provisions of General Notice 2296 issued on 3 October 2003

NCM / GCM relationship:

- how often margin is calculated that is called by the GCM
- how margin is calculated i.e. is a "reasonableness" check performed or is the exact amount of margin calculated
- if applicable, procedures for depositing funds with its GCM for the purpose of covering margin

Client relationship:

- how margin is calculated and called from clients in line with LIFFE Rules (Book II, Rule 3.27), by whom and when
- if applicable, procedures for how clients deposit funds for the purpose of covering margin
- if applicable, how is credit extended to clients in line with the provisions of General Notice 2296 issued on 3 October 2003

<p>3a</p> <p>Compliance Related Matters, including personal account dealing</p>	<p>As part of its internal procedures, an applicant should consider documenting the following compliance related matters:</p> <ul style="list-style-type: none"> • audit trail requirements (Rule 8301 – Book I); • record-keeping requirements (Rule 8302/1 – Book I); • obligations of a Responsible Person (Rule 2202 (Book I) and NYSE Liffe Trading Procedure 3.1 • compliance monitoring – the checks in place to ensure trading activity is conducted in compliance with the Euronext Rules and the NYSE Liffe Trading Procedures • reporting lines to senior staff • the arrangements in place to ensure that staff who will be involved in the conduct of business on the Euronext market are suitable, adequately trained and properly supervised. For example, how will training be undertaken to ensure that trading staff are conversant with the Euronext Rules and NYSE Liffe Trading Procedures, such as the crossing procedures, prohibited practices and Wholesale Trading activities. • how Notices and Info Flashes will be distributed to relevant staff • if the applicant permits Personal Account (“PA”) dealing, how and by whom is monitoring of PA accounts conducted to ensure no conflict of interest <p><u>Specific to the London Market (“LIFFE)</u></p> <ul style="list-style-type: none"> • LIFFE Rule Book II 4.3 - prohibited practices, which include, for example, wash trades; and • LIFFE Rule Book II 4.6 - trading by a Director or employee of a Member
<p>3b</p> <p>Account Opening and Client Agreements</p> <p>Relevant only to those firms trading on behalf of customers</p>	<p>Applicants who intend to trade on behalf of clients will need to document the approval process for new clients, identifying the departments involved and who gives the final approval for a new client. The procedures should include:</p> <ul style="list-style-type: none"> • details of which departments are involved in the opening of a new client account • what is the procedure for new client accounts • who approves a new client • do clients need to have deposited funds in advance of trading access being given • can clients begin trading before final approval is given <p>For the London Derivatives Market, please also refer to the relevant General Notices and Circulars on this subject available from the Audit, Investigations and Membership department or by email at derivativesmembership@nyx.com</p>

4.

Deliverable Contracts

Some of the Euronext Derivative contracts are deliverable. The Audit, Investigations and Membership department will be able to confirm these product groups if you are unsure.

For all deliverable contracts, regardless of whether an applicant intends to make or take delivery of a contract, an applicant must ensure it has procedures in place, if only to prevent the making or taking of delivery. The procedures should include:

- if non clearing, confirmation from its clearing member that it will act as the applicant's delivery agent
- position maintenance
- delivery of stock / underlying
- trade clearing on the day of execution
- T+1 Trade Correction
- position reconciliations

Equity Contracts

- whether there is a stock borrowing facility in place (if non clearing, with your clearing member);
- if non clearing, will there be automatic exercise instructions in place with your clearing member? If so, in what circumstances (e.g. in-the-money and at-the-money options)
- is there an automatic abandonment function for out-of-the-money options on expiry?
- if non clearing, what procedures are in place where exercise is not automatic, e.g. exercise ahead of expiry, abandonment of in-the-money options, exercise of out-of-the-money options? What instructions will be provided to your clearing member, by when, how and by whom?
- what are the procedures where assignment against the applicant occurs on a short position? How is the applicant notified?
- what reconciliations are performed, how frequently and by whom?
- if non clearing, where are positions held i.e. under the applicant's mnemonic or under the clearing member itself on behalf of the applicant?

Financial and Commodity Contracts

- when is the cut off period for trading the front month i.e. not in actual expiry month
- who checks date of Notice Day, ideally closing out 2 days prior to the first Notice Day, and who notifies whom and determines what actions must be taken to ensure traders are aware
- who checks there are no open positions coming into expiry period
- when is the check made?
- Is this double checked / signed off by senior / responsible Members of staff
- error situations: what happens when a position is identified
- what if the applicant fails to trade out of the position?
- what procedures and communications are in place with the clearing member?
- who authorises actions?

Specific to the London Market (LIFFE)

N.B. For Coffee / Sugar / Long Gilt - these are deliverable at any point in the delivery month and therefore procedures should cover the monitoring and closing out of positions prior to the delivery month.

Further Information

If you require further guidance on your manual and you have not yet been assigned a contact person within Audit, Investigations and Membership, please email derivativesmembership@nyx.com or contact Alison Hodge on +44 (0)20 7379 2214 or Charlotte van Cuylenburg +44 (0)20 7379 2283.