INTERNAL CONTROL SYSTEMS

TRDEZ INVESTMENT PRIVATE LIMITED

Version- 1.0

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Version No:	1.0
Date:	06/10/2023

Document Control

Document Title **INTERNAL CONTROL SYSTEMS**

Version History

Version No.	Version Date	Author	Summary of Changes	Approval By	Title	Date of Approval
1.0	06/10/2023	Ms. Vanshika Ghag Governance Risk and Compliance Analyst	NA	Mr. Chetan Dhar Compliance Officer	INTERNAL CONTROL SYSTEMS	06/10/2023

Distribution

Name	Title	Date of Issue	Version No
NA	NA		NA

INTERNAL CONTROL SYSTEMS

Introduction

A well organized and controlled system of working always helps to prevent errors and omissions, especially in share broking business. We are entering into a new competitive and highly sophisticated era, where a self-regulation is a must requirement.

The concept of Self-Regulation

One of the unique features of securities regulation in the US is that, to a very large extent, the system relies on market participants to regulate their own activity. The decision to create self-regulation model can be explained by the historical context in which securities laws were enacted.

International Scenario

The SEC was established when Congress enacted the Securities Exchange Act of 1934. At that time, the NYSE had already been in existence for over one hundred years.

- About 30 Stock Exchange existed in 1934, but the NYSE was by far the largest. In terms of volume, the NYSE accounted for about 80% of the securities trading in the United States.

- The country was recovering from the Stock Market crash of 1929, and there was a consensus that some form of Federal Regulation was necessary. Rather than writing all the rules and responsible for enforcing them. Congress chooses to let Stock Exchanges continue regulating their own activities. SEC got the job of watching over the Stock Exchanges to ensure that they met their self-regulatory responsibilities.

- As a result of the insider/misleading information by certain brokerages and their Member Broking arms, both the SEC and Congress are exploiting the potential benefits of establishing as Self-Regulatory Officer for accountants/stringent disclosures norms.

Indian Perspective

The Securities and Exchange Board of India established in 1992, at the time of when BSE had already been in existence for over hundred years.

- In 1992 about 22 Stock Exchanges existed, but BSE was by far the largest. In terms of the volume, the BSE accounted for about 80% of the securities trading in India Capital Market.

- The country was recovering from the Stock Market crash of 1992, and need was for some form capital Market Regulator. Although SCRA, 1957 continues to enforce Rules and Responsibilities on the Stock Exchanges, SEBI got the job of watching over the Stock Exchanges to ensure that they are met these laws.

- As a result of Vanishing brokers, fly-by-night operators, unprofessional like business conduct, both the Stock Exchanges and SEBI have explored and implemented the "Model Code of Conduct".

Internal Control Systems

- Trading function
  - Dealer-wise exposures / MTM limits
  - Group-wise trading limits (A, B1, B2, Nifty, Junior, CNXIT etc)
  - Credit / Market Risk

- Surveillance function
  - Know your-clients
  - Trading in illiquid stocks
  - Financial position of clients
  - Due-Diligence

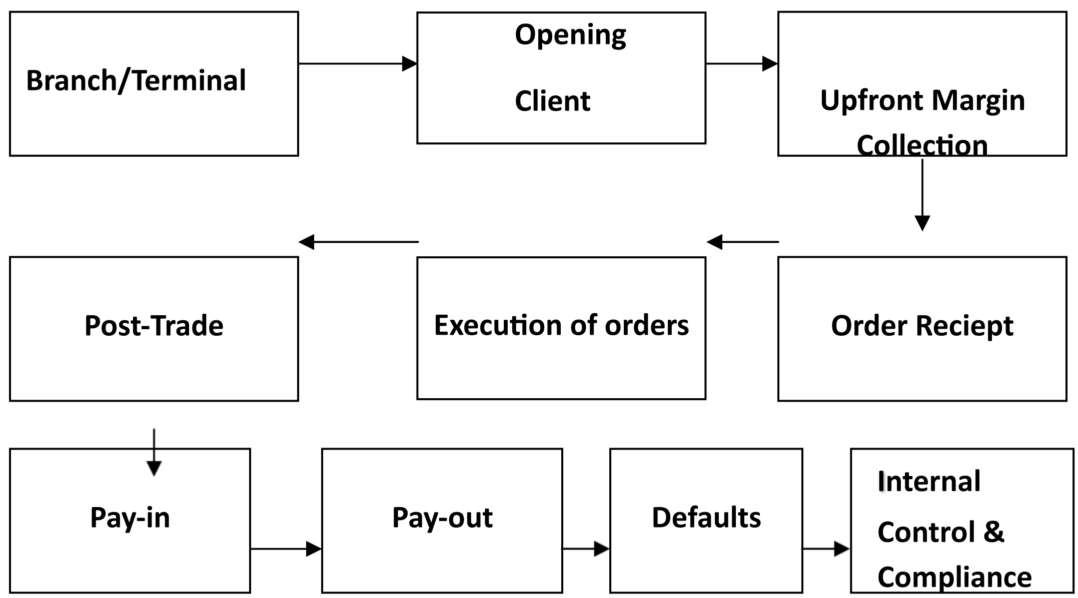
- Audit & Internal Controls
  - Random / Comprehensive Inspection
  - Internal Auditor
  - Investigation

- Back-office & Middle office
  - No netting / adjustments between clients
  - Timely pay-in / pay-out to clients
  - Risk Managements

- Investor / Customer Services
  - Redressal of grievances
  - Customer’s feed back
  - Customer’s queries

- Other functions
  - Training
  - Research and Publication
  - Corporate Governance

Typical work flow of internal control systems



1. **Branch / Terminal**

- Authorization of exchange is necessary for Terminal ID, Approved location
- BOLT / NEAT / CTCL can be located at registered office of the broker member, his branches or at his registered Sub-broker's/Authorised Person's office
- Separate permission required if terminal given to another member of the exchange or member of another exchange.
- In case of NSE, CTCL can be installed at Authorized person's premises (deemed branch)
- In case of BSE, BOLT/CTCL cannot be installed at remiser's premises.
- Proprietary trades can be executed only through designated terminals.
- Can be operated by person by person who has passed NCFM / BCDE.
- Policy regarding setting up the terminals overseas.

2. Opening Client Accounts

- "Know your Client" (KYC) form in the specified format along with necessary supporting for POI & PoR – To Know the back ground of client.
- Requirement of Risk Discloser (RDD) – keep client informed for risks associated with Capital Market/Cash/Future and Option Market.
- Enter into Member-client Agreement with direct client as per format prescribed by SEBI for each Exchange
- Tripartite Agreement in case of client of sub-broker (essentially in cash Market)
- Specific requirements for HUF, PARTNERSHIP, LLP, NRI , OBC ,

Institutional Accounts

MAPIN…….!!! 31/3, 30/6, 1/12, 31/12, 31/3….road ahead

- KYC to be complete in all respects
- Taking income details of client who is willing to trade in future and option segment.
- Common discrepancies observed are:

1) Client photo not signed across by him
2) Agreement is undated or unsigned
3) Agreement is on invalid stamp paper
4) DP details and Bank details not mentioned
5) Board resolution of a corporate client authorizing in dealing through broker not obtained
6) No comment on relevant photocopies that client's identity and address proof have been verified with original
7) Trading Authorisation not available incase trades are executed by the client's representative
8) Witness/ Member's signature by authorized signatories
9) MOA, AOA and annual accounts of last three years not obtained from client

10) Dealing with client started before the date of agreement
11) Letter from client to treat credit balance/security lying with broker as margin not obtained
12) PAN no. details not available (since optional in KYC)
13) Unique client code along –with PAN no./other details has to be updated to exchange system
14) Separate agreements for Internet Trading /Margin Funding
15) Additional clauses can be added, provided they are in conflict to the Model Agreement
16) Agreement / KYCs are not mandatory in case of Institutional clients such as FIIs, IFIs, MFs, Banks etc. provided empanelment letters are in place
17) UCC & CP code for NRI clients to trade in Derivatives
18) New changes in client registration from
19) Bankers' certificate no longer needed
20) Annual Income clause changed to include range of income
21) Market value of portfolio clause substituted with Experience clause
22) One proof each of identity and residence
23) Annual Accounts and Shareholding Pattern made mandatory for annual submission, instead of collection of net worth certificate and IT return
24) Personal details of directors not required instead photographs and names and residential addresses of promoters, whole time directors, persons authorized to deal in securities and persons holding more than 5% of share capital directly or indirectly.

3. Upfront Margin Collection

- In cash market:
    - 20% Margins or VAR margin whichever is higher shall be collected from all clients in full who have executed trade towards margin.

- In derivatives market:
    - o Upfront margin as prescribed by exchange based on SPAN model to be collected.
    - o MTM to be collected in cash on daily basis.
    - o Exchange to be informed daily whether these margins have been collected from all clients.
    - o Margin from FIIs
    - o Yes, if it is not registered with SEBI

4. Order Receipt

- o UCC must be entered while inputting a client trade.
- o Margin funding client must have UIN code (MAPIN).
- o All Proprietary trades to be marked “pro” or “own”.
- o Client order book to be maintained in prescribed format.
- o No internal crossing of orders allowed.
- o Chinese wall / Client’s confidentiality on order receipt.
- o All orders must be exposed to the market.
- o Synchronized orders or inputting orders at artificially high/low prices in the market are considered serious violations.
- o Permission of client needed before broker acts on principal-to-principal basis.
- o Policy for block deals, big deals, orders above certain value & equity capital.
- o Scrip-wise, client-wise, member-wise limits in the Derivatives

5. Order Execution

- Order execution to be informed to client in reasonable time.
- Circular trading is a serious violation.
- Client orders must get priority over own orders.
- Detailed policy required on employee trading, grey lists, proprietary trading etc. as per Insider Trading Regulations.

6. Post Trade

- Contracts/Electronic Contracts to be issued to clients within 24 hours of trading day.
- Acknowledgment copies of contract notes/log file of ECN to be obtained and preserved.
- Only authorized persons can sign contract notes.
- Authorized persons' name and specimen signature to be filed with exchanges.
- Contract Notes shall be in specified format containing Member's SEBI Reg. No., PAN, MAPIN, Service Tax No, arbitration clauses, etc..
- Details such as brokerage, price shall be shown separately.
- Guideline on Electronic Contract Notes.
- Contracts notes must have running serial number for a financial year .
- Serial no. shall begin / reset at the beginning of each financial year.
- PAN details of the client need to be printed on the contract exceeding Rs. 1 lac value.
- Brokerage should not exceed beyond maximum prescribed limit.
- Name of authorized person and branch details need to be printed.
- Contracts note need to be issued even for arbitrage / directors transactions.
- Statutory levies like service tax, stamp duty, turnover tax, SEBI fees and exchange fees must be separately shown.

7. Pay-in

- Securities register detailing shares received from and delivered to be clients in prescribed format need to be maintained.
- Broker cannot accept third party cheques from client.
- Broker cannot accept share of third party either.
- Broker must have systems to check above two requirements.
- CASH NO! NO!!
- Demand Draft, after due verification of bonafide

8. Pay-out

- Securities received in pay-out on clients' behalf must be delivered to him within 24 hours.
- Money due to the client must be paid to him within 24 hours of pay-out.
- Client money should be kept in separate bank account and cannot be used for any purpose other than payments to clients.
- One client's money cannot be used to meet other client's requirements.
- Funding to client is not allowed as a business unless margin guidelines are adhered to.

9. Compliance

- Compliance officer has to be appointed by every broker.
- SEBI certificates must be displayed in the broker premises.
- Notice board of a prescribed size and containing prescribed matter has to be displayed at the entrance of the broker premises.
- Any changes in MOA/AOA, share-holding pattern, directorship, constitution etc., needs exchange's and certain cases SEBI's prior approval.
- Each client must be sent half yearly statement of securities and funds.
- Margin register in prescribed form has to be maintained.

- Quarterly certificates need to be submitted to exchange regarding compliance with margin rules.
- Annual report of a broker needs to be submitted to the exchange within 6 months of end of financial year along with net-worth certificate in prescribed format
- UCC details have to be submitted to the exchange every month.
- If broker offers PMS facility then the same should be compliant with SEBI's PMS regulations.
- Brokerage can be shared only with registered sub-brokers/ remisiers/ authorized persons.

Trdez Compliance Standards

- Exercise due skill and care during introduction of new clients
- Do not advise to trade stocks based on rumors
- Dealing with registered intermediaries
- Do not deal in cash (non-cheque) transactions
- Intimation of proprietary trading
- All trades executed on Exchange trading system
- Chinese wall between dealing and other departments
- Employees code of conduct policy
- Client's funds and securities at arm's length

FOR TRDEZ INVESTMENT PRIVATE LIMITED