



Common Operations Conventions

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1. Know Your Client

Most deals in the OTC financial markets are entered into orally over the phone. Knowing precisely which legal entity you are dealing with is important both when the deal is initiated and when handling confirmations. Particular care is required when the deal is being done with or on behalf of an offshore banking unit (OBU).

Due to many banks centralising their operations, special attention is now required to record the correct booking entity. As an example, you may deal with an organisations' New Zealand office, but the deal is booked and settled with its London office.

The ISDA Master Agreement documentation states that "if a party is specified as a multi-branch party in the schedule, such multi-branch party may make and receive payments or deliveries under any transaction through any office listed in the schedule, and the office through which it makes and receives payments or deliveries with respect to a transaction will be specified in the relevant confirmation".

Robust know-your-client procedures are now also a key prerequisite for transactions with all counterparties to comply with anti-money laundering, anti-terrorist financing and Financial Services Reform Act (FSRA) licensing requirements.

2. Confirmations

2.1. What is a Confirmation?

Confirmation is one of the primary functions carried out by a treasury operations department in minimising risk.

Many financial market deals are the result of oral negotiations and parties are bound from the moment they agree to the economic terms of the deal. However, because of the possibility of misunderstanding or of disputes about the exact terms, market practice is to confirm all details of all deals, either electronically or in writing.

The exchange of a complete and accurate bilateral confirmation signifies that both parties agree on the details of a deal.

A bilateral confirmation ensures that both parties are bound by the terms of the transaction. Confirmation should take place as soon as possible after a transaction is executed so that any errors can be detected and corrected promptly, ensuring minimal risk to the counterparties.

There are two main types of confirmation - primary and secondary. A primary confirmation is the initial information exchanged by the counterparties after they execute the transaction. This can be by electronic, verbal or written communication. A secondary confirmation follows as a formal verification of the details. This is usually by letter or some other written form. Where transactions are confirmed via the ASX Austraclear Electronic Trade Confirmation system, no hardcopy secondary confirmation is required.

2.2. Matching of Confirmations

Good market practice requires not only confirming each deal, but matching the contents of incoming and outgoing confirmations to ensure that the terms of the deal are identical from both counterparties' perspectives.

Errors may occur at two stages in the dealing process: either the deal is booked incorrectly or there is a mistake in the confirmation even though the deal is booked correctly. In both cases it is necessary to correct the error and reconfirm the deal. When using SWIFT or facsimile to confirm deals (the relevant SWIFT standards are explained in the [SWIFT User Handbook](#)), an amended confirmation may be sent or a cancellation and replacement issued.

Matching confirmations will avoid errors, prevent costly payment mistakes and greatly increase operations processing accuracy. Deals should be matched (and if necessary corrected) promptly, ideally within 24 hours of the exchange of confirmations. Some deal types may require faster matching, which generally requires the use of an automated matching system.

Where possible, and particularly where volumes/exposures indicate, market participants should use an electronic matching system to match all eligible deals (CDS, foreign exchange, loans/deposits and forward rate agreements).

2.3. Acceptable Forms of Confirmation

2.3.1. Facsimile

Once a bilateral 'fax indemnity' is in place, a facsimile is an acceptable form of secondary confirmation.

2.3.2. SWIFT

Standard-format SWIFT messages are used for secondary confirmation of a range of transaction types. In the case of interbank transactions, bilateral confirmation by way of standardised authenticated SWIFT message is now an acceptable alternative to the exchange of hardcopy or faxed confirmations.

The formatting of SWIFT messages for the processing of derivatives trades is demonstrated in the [SWIFT User Handbook](#) standard category 3. The confirmation messages in this category are confirmations of information already known to both parties and are not used for the transfer of funds.

These messages provide details on:

- confirmation
- settlement
- advice/instruction

The standard messages should be used correctly to maximise straight-through processing.

Correct use of standards includes the following procedures:

- A bank identifier code (BIC) with option A should be used in the 'party' fields whenever an institution has one, even if it is not yet live on SWIFT
- Field 72 should be avoided unless important information is to be conveyed for which no specific field exists

Market participants can use the SWIFTNet Accord solution for confirmations matching and exceptions handling.

2.4. Amending Deals

If any details of a deal are amended after the initial confirmation has been executed, the deal must be reconfirmed.

Confirmation procedure is the same as the original confirmation except that the parties are to make it clear that they are confirming an amendment to an existing deal rather than a new deal.

It is recommended that a full audit trail of appropriately approved amendments be kept.

3. Settlement

3.1. What is a Settlement?

“Settlement” is the exchange of an agreed currency amount or exchange of security on a specified value date. Settlement can take a number of different forms including:

- A one-way cash payment either electronically or physically
- Cash is exchanged for a security – if simultaneously, known as “Delivery versus Payment” (DvP)
- A payment of one currency for the receipt of another currency

3.2. Standard Settlement Instructions (SSI)

SSI is a listing of standard account details through which a financial markets participant pays and receives cash or securities in settlement of transactions. The details include the name and location of the bank, the account number and usually the SWIFT addresses.

If SSI are in place it is possible to take advantage of straight through processing.

If SSI are not in place, full payment instructions should be exchanged at the time of the deal and no later than the time of the confirmation.

Where one counterparty wishes to deviate from the SSI, it is the responsibility of the deviating party to advise its counterparty of the amended or changed instruction prior to settlement. The ISDA standard is that notice should be given at least five Local Business Days prior to the Scheduled Settlement Date for the payment or delivery to which such change applies unless such other party gives timely notice of a reasonable objection to such change

3.2.1. SSI Issuing Procedures

When SSI are issued or amended the following procedures are followed:

- For interbank communication of SSI, SWIFT broadcast is the recommended medium. For communications to non-SWIFT members, SSI should be issued on the institution's letterhead and must be signed by authorised signatories. In the case of corporate clients, all SSI notifications must be in writing and signed by the appropriate authorised signatories.
- A copy of the written advice should be provided to allow the recipient's authorised signatories to sign and return the advice as acknowledgment of receipt.
- The list of SSI should clearly identify and highlight any changes made to previously advised instructions. For example, changed instructions could be listed separately from a complete listing of all instructions, thereby drawing the recipient's attention to the changes.
- Each page of the lists should be signed by authorised signatories. It is also recommended that pages be numbered "1/5", "2/5" etc.
- A covering letter must show clearly and unambiguously when the new SSI are effective and whether the changes apply to new deals only or to all outstanding transactions. The effective date should also appear on the lists attached to the letter.
- Counterparties to whom changed instructions are sent must be given sufficient time to acknowledge receipt of the written advice. Two weeks is considered reasonable. Therefore, amendments/new SSI should reach counterparties at least two weeks before the effective date of the amended/new SSI.
- It is the responsibility of the issuer to monitor receipt of acknowledgments and initiate appropriate follow-up action prior to the changes becoming effective for non-SWIFT broadcast communications. Where a SWIFT broadcast is utilised to inform of new SSI details, the responsibility is on the receiver to update its own internal systems with the new information.
- Individual organisations will have risk and compliance guidelines regarding method of confirmation of SSI information.

3.3. Settlement Methods, Systems and Documentation

3.3.1. Australian Payments Clearing Association

www.apca.com.au

APCA is a public company owned by banks, building societies and credit unions. It has been in existence since February 1992 and has specific accountability of key parts of the Australian payments system, particularly payments clearing operations.



APCA coordinates, manages and ensure the implementation and operation of effective payments clearing and settlement systems, policies and procedures. It is currently responsible for establishing and managing five payments clearing systems. Clearing systems provide a single, clear body of rules and decision-making structures governing the conduct of clearing and settling.

APCA does not process payments. Individual institutions participating in each clearing system are responsible for their own clearing operations, which they must conduct according to APCA's rules.

Clearing system management involves a participatory approach. The members of each clearing system appoint a committee of management with delegated powers and responsibilities. System members participate in annual meetings, which provide a forum for discussion on all matters relating to the operations and management of the relevant system.

The company's reporting and decision-making structure ensures a high degree of co-ordination in managing and developing Australia's payments clearing arrangements. Membership criteria, and conditions of access and participation, are open to scrutiny and can be changed as circumstances change. Trade practices authorisation has been granted for the activities of APCA and its existing clearing systems on public benefits grounds.

APCA's charter allows it be responsive to developments in payments services. It is not restricted to regulating clearing and settlement of prevailing payments services and can adapt to the development of new payments systems by altering the classification and structure of its existing clearing systems or creating new clearing systems as the need arises.

3.3.2. Real-Time Gross Settlement (RTGS)

http://www.rba.gov.au/PaymentsSystem/Rits/legal_framework.html

The introduction of RTGS by the Reserve Bank of Australia (RBA) in June 1998 has contributed to a reduction in credit, settlement and systemic risks. The RBA's RTGS system is known as the Reserve Bank Information and Transfer System or 'RITS'.



RTGS systems, such as RITS, help limit payments system risk. Payments are tested for irrevocable settlement from the time they are received in the payments system. This contrasts with the net-deferred method, which allows participants to make payments on an unrestricted basis during the day without settlement testing. Final settlement in these systems does not occur until the successful completion of the exchange settlement process on the following business day.

In the RTGS system, processing and final settlement of funds transfer instructions take place continuously and immediately. As it is a gross settlement system, transfers are settled individually, without netting debits against credits. Moreover, the settlement process is based on the real-time transfer of central bank money across Exchange Settlement Accounts (ESAs) held at the Reserve Bank. RITS can thus be characterised as a funds transfer system that is able to provide continuous intra-day finality for individual transfers.

ESA holders, mainly banks and other authorised deposit-taking institutions, must manage their intra-day liquidity requirements in real time to ensure all payment obligations are met. ESA holders must therefore have sufficient funds in their accounts with the RBA at all times throughout the processing day. If an ESA holder faces the prospect of a shortfall of available funds during the day it must have the limits and ability to be able to borrow exchange settlement funds from the market or enter into a reciprocal purchase agreement or 'repo' with the RBA.

The SWIFT payment delivery system (PDS) carries large-value payments, which settle in RITS on an RTGS basis. SWIFT's FIN-Copy function passes the settlement details through to the RBA using a central computer interface. SWIFT PDS is administered by APCA. Membership of SWIFT PDS is open to the RBA and all ESA holders.

The RBA put in place new RITS session times with the introduction of continuous linked settlement (CLS) for FX transactions in September 2002. CLS is a global initiative designed to reduce FX settlement risk.

3.3.3. ASX Austraclear

www.asx.com.au

ASX Austraclear's main function is as a Central Securities Depository. It facilitates exchanges in certificates of deposit, commercial paper, semi-government bonds and notes, bills of exchange, fixed and floating rate securities and securitised assets by removing the need for a physical transfer of paper. It electronically records book-entry changes in ownership of entitlement as securities are traded or pledged as collateral. The transfer of securities occurs on what is known as a delivery versus payment (DVP) basis, i.e. ownership of securities does not change until the system receives advice that funds are cleared or free of payment (DFP) i.e. ownership of securities changes with no cash component. This means that the risk of trade failures is eliminated. Participants have the reassurance that transactions are settled in real-time funds and are confirmed by a bank.



It is important to note that ASX Austraclear is not a dealing-room trading system. It is not an exchange clearing house and it does not become party to the transaction.

Although its primary focus is as a depository for securities, the ASX Austraclear system (EXIGO) also facilitates exchange of irrevocable AUD payments (cash) between participants. ASX Austraclear allows Participants to coordinate their cash transactions with their banks.

ASX Austraclear delivers a range of service options designed to streamline operational processes and enhance market participants' straight through processing capabilities. Some of these options relevant to debt market transactions include:

- Deal instruments trade entry and confirmation
- Automatic or manual (depending on the option selected at the deal entry stage) electronic deal settlement
- ASX Austraclear offers the capability to settle electronic cash transfers via RTGS. The electronic cash transfers (ECTs) are two-sided and can be bank-to-corporate (B2C), corporate-to-corporate (C2C) or bank-to-bank (B2B). ASX Austraclear also accommodates fall-back end of day settlement in the event that RTGS becomes unavailable
- ASX Austraclear provides SWIFT members with the ability to interface directly with EXIGO via the SWIFT system
- Host-to-Host Lite provides an alternative method of delivering FIS trades or payment instructions to the ASX Austraclear system. Participants input transactions on their own computers and transfer/ download a file of these transactions directly to the system

ASX Austraclear participants include licensed banks, merchant and international banks, major life insurance, superannuation and trust companies, Federal and State Government bodies, security dealers and brokers. Each Participant is bound by the regulations contained in the Regulations and Operations Manual. These regulations detail the rights and obligations of all parties involved with the EXIGO system. Those wishing to join ASX Austraclear must satisfy the Board of ASX Austraclear that they are able to conform to its regulations and nominate a banker and bank account to enable ASX Austraclear to secure a bank guarantee for cash transactions.

3.3.4. Society for Worldwide Interbank Financial Telecommunications (SWIFT)

www.swift.com

SWIFT is a worldwide community of financial institutions whose purpose is to be the leader in communications solutions enabling interoperability between its members, their market infrastructures and their end-user communities.



SWIFT's stated mission includes:

- To work in partnership with its members to provide low-cost, competitive financial processing and communication services of the highest security and reliability
- To contribute significantly to the commercial success of its members through greater automation of the end-to-end financial transaction process, based on its leading expertise in message processing and financial standards-setting

- To capitalise on its position as an international open forum for the world's financial institutions to address industry-level threats, issues and opportunities

SWIFT provides technology based communication services throughout the financial markets. Standardised message formats promote compatibility with other systems. Australian financial institutions use SWIFT to send instructions to their bankers to make payments on their behalf. SWIFT is also used by financial institutions to exchange electronic confirmations.

Services and facilities offered by SWIFT to the international financial industry include:

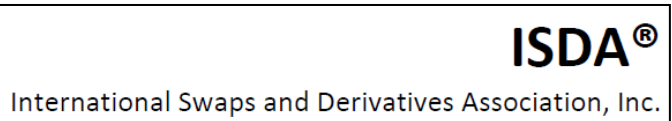
- Financial telecommunications (the transmission of standardised financial transactions from one user to another user in the form of structured messages)
- Message format standardisation

In order to ensure error free identification of parties in automated systems, SWIFT developed the bank identifier code (BIC). The BIC is a unique address which, in telecommunication messages, identifies precisely the financial institutions involved in financial transactions.

3.3.5. ISDA® Master Agreement and User's Guide

www.isda.org

ISDA, which represents participants in the privately negotiated derivatives industry, is among the world's largest global



financial trade associations as measured by number of member firms. ISDA was chartered in 1985 and today has over 830 member institutions from 58 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core business activities.

Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business. Among its most notable accomplishments are:

- developing the ISDA Master Agreement;
- publishing a wide range of related documentation materials and instruments covering a variety of transaction types;
- producing legal opinions on the enforceability of netting and collateral arrangements (available only to ISDA members);
- securing recognition of the risk-reducing effects of netting in determining capital requirements;
- promoting sound risk management practices; and

- advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives.

The ISDA Master Agreement is used in conjunction with the various ISDA Definitions booklets (including standard formats for confirmations) to document a wide range of OTC derivatives transactions, between market participants as well as with end-users, both within Australia and across different jurisdictions. The most recent version is the 2002 ISDA Master Agreement.

For OTC derivatives transactions, the ISDA Master Agreement is the most widely accepted documentation used globally. Use of the ISDA Master Agreement in Australia is covered extensively in the AFMA "Guide to Australian OTC Transactions".

Counterparties should ideally have an ISDA Master Agreement in place prior to entering into OTC derivatives transactions. Where a transaction is agreed prior to the execution of a master agreement, the confirmation should state that the transaction has been entered into on the basis of the standard terms contained in the ISDA Master Agreement pending negotiation and execution thereof.

3.3.6. Continuous Linked Settlement (CLS)

Refer to the [Foreign Exchange Conventions](#).

3.4. Indemnity for Telephone and other Unauthenticated Instructions

Use of the following documents is recommended where a corporate client is prepared to accept the risks involved:

- Financier's letter to customer
- Fax/internet indemnity

These recommended documents are the outcome of consultation with legal adviser, Mallesons Stephen Jaques.

Their development arose from industry concern at the attendant risk from the increasing volume of unauthenticated fax payment instructions from corporate clients.

The decision to introduce the fax indemnity document has led to an increased awareness of the risks involved. Rather than sign the indemnity, many companies have chosen to significantly tighten their operating procedures, which has led to improved industry practice. Such improved practices include better know-your-client procedures, measures to confirm the authenticity of the sender and the use of PDF documents for internet based instructions.

Financier's letter to customers

[On Financier's letterhead]

[Date]

To: [Name of Customer and address]

**Foreign Currency and Money Market Transactions -
Telephonic and other unauthenticated instructions**

[Insert name of Financier]'s [new] policy with reference to the acceptance of authenticated instructions from its customers is set out below.

[Insert name of Financier] is prepared to accept and act on instructions given by telephone or other electronic means only where the risk of fraud or unauthorised transactions is taken by the customer. Accordingly it will be up to the customer to ensure that it adopts procedures to minimise these risks.

[Insert name of Financier] will agree to act only on the instructions of persons who purport to be the persons authorised by the customer (and for this purpose the customer should provide us with a list of authorised persons). However, the customer will be bound by instructions received by us from any person purporting to be an authorised person unless the customer has notified us that instructions are no longer to be accepted from that previously authorised person.

If having understood the associated risks you wish to have us act on instructions given by telephone, telex, cable, facsimile or other electronic means you must execute and return to us the attached Indemnity.

Yours faithfully,

[Name]

[Title]

for and on behalf of

[Insert name of Financier]

Fax indemnity

TO: [the Financier]

FROM: [the Customer]

IN CONSIDERATION of [insert name of the financial institution] (the Financier), which expression shall include its successors and assigns, agreeing to act on the basis of instructions given by the Customer by telephone, telex, cable, facsimile or other electronic means, the Customer agrees as follows:

1. All risk of unauthorised instructions or fraud lies with the Customer and is not to be borne by the Financier.

2. The Customer agrees to indemnify the Financier and hold it harmless against:

(a) any and all claims which the Customer or any third party may have against the Financier for any damage, loss, cost or expense which the Customer or that third party may suffer or incur (whether directly or indirectly and whether foreseeable or not); and

(b) any damage, loss, cost or expense which the Financier may suffer or incur (whether directly or indirectly and whether foreseeable or not)

as a result of or in connection with:

(c) the Financier acting upon any instructions purporting to be from the Customer or an employee of the Customer (whether by telephone, telex, cable, facsimile or other electronic means); or

(d) the Financier not acting upon any instructions purporting to be from the Customer or an employee of the Customer (whether by telephone, telex, cable, facsimile or other electronic means) where the Financier (in its subjective determination) considers or suspects that such instructions have been communicated to the Financier fraudulently, mistakenly or without authority or contain material omissions or errors.

Nothing in clause 2 shall be construed as requiring the Financier to make any inquiries as to the genuineness or validity of an instruction.

3. The Indemnity contained in clause 2 is subject to the Financier acting only upon instructions from persons purporting to be the Customer or person authorised by the Customer from time to time by notice to the Financier.

For the purposes of this clause a person shall be deemed to be a person authorised by the Customer if the Customer has held out that person to the Financier as a person authorised by the Customer and has not notified the Financier in writing that such person has ceased to be authorised.

Dated the day of 20.....

THE COMMON SEAL of)
)
)
was affixed by authority of the Board of Directors)
)
in the presence of: Director)
)
Secretary)

3.5. Reconciliation

3.5.1. What is reconciliation?

The reconciliation function in treasury operations is the final verification that the settlement process has taken place correctly for each transaction and that the appropriate account has been debited or credited. Reconciliation can take a number of forms.

3.5.2. Reconciliation of all Outstanding Transactions

This reconciliation can take place in one of two formats. On a regular basis financial market participants confirm either all outstanding transactions or select a sample. They may issue an audit confirmation letter to counterparties requesting them to confirm outstanding transaction details. Recipients of such a letter reply to the issuer noting any transaction detail differences, which are then investigated and reconciled.

3.5.3. Dealer Position Reconciliation

Either progressively during the day, or at close of business, the dealer's currency/product position is reconciled to internal blotter/system records. This procedure is of vital importance as it is imperative that the dealer is trading from correct internal records. Costs (losses) can be incurred where a position is incorrect and the true position is therefore not being managed.

3.5.4. Timeliness

The timely reconciliation, prompt investigation and resolution of any discrepancies are essential in treasury operations. Failure to follow up items immediately increases the risk of nostro overdraft costs or late settlement costs. Unreconciled items can also lead to market and credit risks.

3.5.5. Settlement Failure

Early detection of a counterparty's failure to settle is crucial. Failure to settle could be simply an error or oversight by the counterparty, but it could be something far more serious, such as a lack of funds. In this situation early detection of the problem could minimise potential losses.

3.5.6. Nostro/Cash Account Reconciliation

A participant in the financial markets holds different currency accounts for payment and receipt of funds in settlement of non-AUD transactions or transactions with non-AUD legs. A foreign currency account with an offshore bank (correspondent) is called a 'nostro' (our) account.

Reconciliation of these accounts must be performed for all currencies.

The main purpose of the nostro/cash account reconciliation is to ensure that expected cash movements agree with the actual cash movements of each currency in the nostro/cash account. If differences exist, a financial institution must follow up with either the correspondent or the counterparty to resolve the difference. The difference may be caused by incorrect capture of trade information or the correspondent making an error with a payment. Accuracy and efficiency in the confirmation process avoids most errors relating to incorrect settlement.

If the nostro/cash account reconciliation is not performed, or is performed incorrectly, the actual account balances may be different from internal records. This will result in the financial institution paying overdraft costs on short balances or receiving less than market rates on any long balances. In some circumstances, market risk can be incurred where an incorrect payment or receipt is a result of a transaction being recorded incorrectly and remaining undetected.

Several types of bank statements are available for reconciliation. These range from SWIFT or other electronically derived means to paper-based statements. Bank statements should be reconciled at the earliest possible time after close of business.

3.6. Investigation

The investigation process determines the cause of a discrepancy and prompt follow-up action will minimise any compensation claims or overdraft charges. This process is normally a result of the reconciliation process that has uncovered a discrepancy or anomaly.

Good value is defined as "giving value to a payment that the payment should have originally had if it had been affected on the original date". If the discrepancy was caused by an error at the bank then the bank must arrange to pay the counterparty the principal sum with good value or to pay the counterparty compensation. Where one organisation has been "unduly enriched" through another organisation's error then the enriched party will be asked to return this benefit. Compensation rules for the calculation of claims apply in various jurisdictions.

3.7. Compensation Rules

3.7.1. Australia

The Australian Payments Clearing Association (APCA) has developed a single set of rules for calculating compensation when a payment is made on a day other than the day agreed, or is made in error to an account or person other than agreed. These rules, known as the [*Standard Inter-Organisation Compensation Rules*](#), came into force on 13 June 2001 and can be applied in any clearing and settlement system where participants settle with each other by adjusting their exchange settlement account balances held with the RBA.

A range of different rules has applied within the financial industry for calculating compensation when errors are made between clearing participants. Which rules apply

depends largely on the nature of the underlying transaction and/or the method of payment used.

Participants in clearing systems may also use these rules in relation to claims by their customers.

3.7.2. United States

In the United States the compensation rules are called the International Financial Services Association (IFSA) Compensation Rules (formerly the CIB rules) and are governed and administered by IFSA.

3.7.3. Other Countries

In other countries compensation rules are set and agreed to by the individual country's market participants.