



# Audit Committee

Terms of Reference

**LME CLEAR LIMITED**

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A private limited company. Registered in England no 07611628. Registered office as above.

[LME.COM/CLEAR](https://www.lme.com/clear)

## 1 Status

The Audit Committee (the “**Committee**”) is a sub-committee of the board (the “**Board**”) of LME Clear Limited (the “**Company**”) to which the Board has delegated consideration of the matters set out in paragraph 4 below.

## 2 Purpose

The Committee is to serve as a focal point for communication between other directors, the external auditor and the internal auditor as regards their duties relating to financial and other reporting, internal controls, external and internal audits and such other matters as the Board determines from time to time.

The Committee is to assist the Board in fulfilling its responsibilities by providing an independent review and supervision of financial reporting, by satisfying themselves as to the effectiveness of the internal controls of the Company, and as to the adequacy of the external and internal audits.

Matters to be considered by the Committee shall include, but not be limited to, the matters set out below in paragraph 4.

The Committee should liaise with Hong Kong Exchanges and Clearing Limited (“**HKEX**”) (together with the Company, the “**HKEX Group**”) and the Audit Committee & Risk Management Committee of HKEX to facilitate group-wide consolidated financial reporting as part of the HKEX Group.

The Committee will take into account HKEX Group reporting requirements and policies in reviewing the financial statements.

Where there is a perceived overlap of responsibilities between the Committee and the Technology and Operational Resilience Committee, the respective committee chairmen will discuss and agree upon the most appropriate committee to fulfil any obligation.

## 3 Administrative Structure

### (a) Composition

The Audit Committee will be composed of at least 4 individuals (excluding the secretary of the Committee). At least 3 individuals shall be appointed from the Non-executive Directors (as defined by the articles of association of the Company). At least one of these individuals shall have relevant and recent financial experience and the committee as a whole shall have competence relevant to the sector in which the company operates. The fourth Committee members shall either be a Non-executive Director or an Executive Director (as defined by the articles of association of the Company).



The chairman and members of the Committee shall be appointed by the Board. The chairman of the Committee shall be consulted on the appointment of other members of the Committee.

Only members of the Committee have a right to attend meetings; however other members of the Board or senior management may be invited to attend, as appropriate. External auditors will be invited to attend meetings on a regular basis.

(b) **Chairman**

The Board shall appoint one the Non-executive Directors of the Company to be the chairman of the Committee. In the absence of the chairman and/or an appointed deputy at any meeting, the Committee will choose from their own another member to act as chairman.

(c) **Secretary**

The company secretary, or their nominee, shall act as the secretary of the committee and will ensure that the committee receives information and papers in a timely manner to enable full and proper consideration to be given to issues.

(d) **Reporting Procedures and Frequency of Meetings**

- (i) Minutes will be taken for all meetings and, when the Committee chairman deems appropriate, tabled at meetings of the Board. Draft and final versions of minutes of the meetings should be sent to all Committee members for their comment and records, within a reasonable time after the meeting. Decisions of the Committee relating to financial reporting should be communicated to the Audit Committee of HKEx in a format deemed appropriate by the Chairman of the Committee. The chairman of the Committee will present an oral report to the Board on the activities and decisions of the Committee.
- (ii) The Committee shall meet at least four times per year at appropriate times in the reporting and audit cycle and otherwise as required. Meetings shall be summoned by the secretary of the Committee.
- (iii) Meetings can be convened at the request of the Committee chairman, members or the external or internal auditors.
- (iv) The Company Secretary or his/her nominee shall be the Secretary of the Committee. Committee meeting dates shall be agreed in advance affording adequate notice for maximum participation. Papers prepared for the Committee may be sent (by appropriate medium) between meeting dates and decisions or recommendations solicited and received between meetings, where necessary, to avoid delays in the decision-making processes.
- (v) The Committee chairman shall report regularly and formally to the Board, at the next meeting of the Board following a meeting of the Committee, on matters within its remit, and any suspected frauds and irregularities, failures of internal control or suspected infringements of laws, rules and regulations which come to its attention and are of sufficient importance to warrant the attention of the



Board. At least annually, the Committee should present a report to the Board which addresses the work and findings of the Committee during the year.

- (vi) Where there is disagreement between the Committee and the Board, adequate time should be made available for discussion of the issue with a view to resolving the disagreement. Where any such disagreement cannot be resolved, the Committee has the right to report on the issue to the shareholder as part of the report on its activities.
- (vii) The Committee shall compile a report to the Audit Committee of HKEx on its activities after each and every of its meetings and on its activities to be included in the Company's annual report.

(e) **Quorum**

3 members shall constitute a quorum.

Decisions shall be determined by simple majority and, in the event of a tie, the chairman of the Committee shall have the casting vote.

Members of the Committee shall generally be appointed for three years, and shall be eligible for reappointment. If a member of the Committee ceases to be a member of the Board, their membership of the Committee shall automatically cease.

## 4 Authority

The duties of the Committee shall be:

### 4.1 Financial Reporting, Internal Controls and Risk Management System

#### 4.1.1 Financial Reporting

- (a) The Committee shall monitor the integrity of the financial statements of the Company, including its annual and interim reports and any other formal announcement relating to its financial performance. The Committee shall review and challenge where necessary:
  - (i) the consistency of, and any changes to accounting policies and practices on a year on year basis and across the HKEx Group;
  - (ii) the methods used to account for significant or unusual transactions where different approaches are possible;
  - (iii) whether the Company has followed appropriate accounting and auditing standards and made appropriate estimates and judgments, taking into account the views of the external auditors;
  - (iv) the clarity and completeness of disclosure in the Company's financial reports and the context in which statements are made;
  - (v) any significant financial reporting issues and judgments and all material information presented with the financial statements, such as significant



adjustments resulting from the audit, and the going concern assumption and any qualifications; and

- (vi) any significant or unusual items that are, or may need to be, reflected in financial reports and accounts, and must give due consideration to any matters that have been raised by the staff responsible for the accounting and financial reporting function, compliance function or auditor (internal or external).

#### 4.1.2 Internal Controls

With respect to Internal Controls other than the ones covered by the Technology and Operational Resilience Committee<sup>1</sup>, the Committee shall:

- (i) monitor, and review with management, compliance, external auditor and internal auditor, the adequacy and effectiveness of the Company's policies and procedures regarding internal controls (including financial, operational, risk management, outsourcing, legal, compliance and those controls designed to detect material fraud, and any statement concerning internal controls to be included in the annual accounts prior to endorsement by the Board;
- (ii) discuss with management the scope and quality of systems of internal control and review annually that management has discharged its duty to have an effective internal control system including the adequacy of resources, qualifications and experience of staff of the accounting and financial reporting function, and their training programs and budget; and
- (iii) discuss with management the adequacy of the Company's policies and procedures relating to financial, operational, outsourcing legal and compliance when required.

#### 4.1.3 Risk Management

With respect to the risks other than the ones covered by the Board Risk Committee<sup>2</sup> and the Technology and Operational Resilience Committee, the Committee shall:

- (i) review the adequacy of the Company's risk management and compliance policies and procedures;
- (i) review the risk management system and compliance strategies of the Company and the framework of risk limits and risk appetite and recommend their approval to the Board;

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<sup>1</sup> The Technology and Operational Resilience Committee is empowered to assist the Board with discharging responsibilities relating to the oversight of technology, change management and operational resilience.

<sup>2</sup> The Board Risk Committee covers risk modelling (for margin, collateral, liquidity, credit risks), default procedures, acceptance of clearing members, clearing of new classes of instruments, and outsourcing of functions.



- (ii) ensure that management has identified material risks facing the Company and that appropriate arrangements are in place to control & mitigate those risks effectively;
- (iii) report on Committee business to the Board with such recommendations as the Committee may deem appropriate;
- (iv) review any risk acceptance decisions made by management and challenge risk information received from the Company's risk management functions to ensure that the Company is not exceeding the risk limits set by the Board; and
- (v) ensure that management present a profile of the Company's key risks and associated controls to the Board at least annually.

The responsibilities of this Committee under 4.1.3 cover operational risks including custody risk, payment and settlement risk and concentration risk.

The Committee has overall responsibility for the Operational Risk Policy, the Investment Policy and the Payment, Settlement and Custody Policy and shall monitor compliance with such policies and review its effectiveness at least on an annual basis.

#### 4.2 **Anti-bribery and Anti-Corruption, Whistleblowing, Fraud Prevention and Financial Crime**

The Committee shall:

- (a) review and approve the Company's assessment of the corruption risks to which it is subject and the framework of controls put in place to mitigate those risks, including but not limited to the Company's policies on anti-bribery and anti-corruption corruption and risk management.;
- (b) monitor and oversee compliance with the Company's anti-bribery and anti-corruption policy including reviewing this policy on an annual basis to ensure that it remains adequate for the purposes of the Bribery Act 2010 (UK) and any other applicable legislation;
- (c) where appropriate, seek advice or information from the Chief Executive Officer or any other person it deems necessary regarding the Company's policy on anti-bribery and anti-corruption or compliance with it; and
- (d) report on Committee business to the Board with such recommendations as the Committee may deem appropriate in relation to anti-bribery and anti-corruption.
- (e) establish and review the Company's policies and systems for its employees and third parties who deal with the Company to raise concerns, in confidence, about possible improprieties in financial reporting, internal control or other matters related to the Company, with the Committee. The Committee shall ensure that proper arrangements are in place for fair and independent investigation of these matters and for appropriate follow up action; and
- (f) review the Company's procedures findings of internal investigations and management's response into any suspected frauds or irregularities or failures of internal controls or infringements of laws, rules and regulations.



### 4.3 Internal Audit

The Committee shall:

- (a) monitor and review annually the effectiveness of the Company's internal audit function, in particular, ensure the adequacy of resources, staff qualifications and experience, training programmes and budget. Ensure co-ordination between the internal and external auditors and ensure that the internal audit function has appropriate standing within the Company and within the HKEX Group;
- (b) review and approve the annual internal audit plan and discuss with the internal auditor any significant findings and recommendations arising from the internal audit activities;
- (c) determine whether it is satisfied that the quality, experience and expertise of internal audit is appropriate for the business;
- (d) ensure that the matters set out in the Annex are independently reviewed (either internally or externally) and have been approved by the right committee. The Audit Committee will have authority to update list in the Annex;
- (e) review and monitor management's responsiveness to the findings and recommendations of the internal auditors;
- (f) meet with the Head of Internal Audit:
  - (i) at every meeting, to discuss their remit and any issues arising from the internal audits carried out. Management of the Company shall not be present for such discussions; and
  - (ii) regularly throughout the year as the Head of Internal Audit shall require.
- (g) where consultants or internal group resources are engaged by management of the Company to review particular aspects of the Company's risk identification and/or risk management issues and/or internal control issues the Committee should have access to all such reports and presentations and if considered appropriate request that such consultant(s) present to the Committee; and
- (h) approve the Internal Audit Charter and review its effectiveness on an annual basis;
- (i) approve decisions regarding the appointment, removal, and salary of the Head of Internal Audit; and
- (j) review the performance evaluation of the Head of Internal Audit.

### 4.4 External Audit

The Committee shall:

- (a) consider and make recommendations to the Board, in relation to the appointment, re-appointment and removal of the Company's external auditors, oversee, in consultation with HKEx, the selection process for new auditors and investigate a resignation by the external auditors.
- (b) oversee the relationship with the external auditors including but not limited to:



- (i) approval of their remuneration (after consultation with HKEx), whether fees for audit or non-audit services and that the level of fees is appropriate to enable an adequate audit to be conducted and approval of their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit;
  - (ii) assessing annually their independence and objectivity taking into account relevant UK professional and regulatory requirements and the relationship with the auditors as a whole;
  - (iii) assessing annually their qualifications, expertise and resources and the effectiveness of the audit process which shall include a report from the external auditors on their own internal quality procedures. Discuss with the external auditor the nature and scope of the audit and reporting obligations;
  - (iv) seek from external auditor, on an annual basis, information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including provision of non-audit services and requirements regarding rotation of audit partners and staff, the level of fees paid by the Company compared to the overall fee income of the firm, office and partner and other related requirements; and
  - (v) agree with the Board the policy relating to the hiring of employees or former employees of the external auditor and monitor the applications of such policy. The Committee will consider whether as a result of such hiring there has been any impairment of the auditor's judgment or independence in respect of an audit. A former partner of the existing external auditing firm should be prohibited from acting as a member of the Committee for a period of 1 year from the date of his/her ceasing to be a partner of the firm or to have financial interest in the firm, whichever is later.
- (c) meet with the external auditors (it being noted that the external auditors may participate in such meetings by telephone):
- (i) at every meeting to discuss their remit and any issues arising from the audit. Management of the Company shall not be present for such discussions; and
  - (ii) regularly throughout the year (including at the planning stage before the audit and at the reporting stage after the audit) as the external auditors shall require;
- (d) review and approve the annual external audit plan and ensure that it is consistent with the scope of the audit engagement;
- (e) review the findings of the external audit with the external auditors (if necessary in the absence of management), including but not limited to, the following:
- (i) a discussion of any major issues and recommendations which arose during the audit;
  - (ii) any accounting and audit judgments;
  - (iii) levels of operational and financial errors identified during the audit; and



- (iv) any disagreements with management which if not satisfactorily resolved would result in the issue of a modified report on the financial statements (i.e. a qualified, adverse or disclaimer of opinion in their report).
- (f) obtain comments of management regarding the responsiveness of the external auditor to the needs of the Company, and review the effectiveness of the audit;
- (g) review any representation letter(s) requested by the external auditors before they are signed by management; and
- (h) review the management letter and management's response to the external auditors' findings and recommendations, and ensure that the Board will provide a timely response to issues raised in the external auditor's management letter.

Notwithstanding the matters above listed as part of the Committee's authority, the Committee shall not have authority to approve any decision that could have a significant impact on the risk profile of the Company. Any such decision shall be referred to the Board for approval.

The engagement of the Company's external auditor to perform non-audit services is in general prohibited except for tax-related services. If a compelling reason exists to engage the external auditors due to their unique expertise in a particular area, this matter shall be considered in accordance with the HKEx Group Policy on external auditors providing services and the prior approval of the Committee is required.

## 5 Other Matters

### (a) Authority and Duties

The Committee shall:

- (i) have access to sufficient resources and training in order to carry out its duties;
- (ii) give due consideration to all relevant laws and regulations, investigate any activity within its terms of reference;
- (iii) have access to members of management, legal counsel, and invite the attendance of outsiders with relevant experience and expertise at any meeting if necessary;
- (iv) undertake regular and thorough review to ensure that the Company is meeting its requirements as a central counterparty;
- (v) at least once a year, review its own performance, constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board for approval; and
- (vi) report on its activities on a quarterly basis to the Board.

In addition to the above, the Committee may investigate, discuss or review matters outside its terms of reference if required to do so by the Board.

### (b) Powers



The Committee is authorised to:

- (i) have access to any information, record or reports it requires from any employee of the Company in order to perform its duties and all employees are directed to cooperate with the Committee;
- (ii) obtain, at the Company's expense, outside legal or other professional advice on any matter within its terms of reference; and
- (iii) call any employee of the Company to be questioned at a meeting of the Committee as and when required.

(c) **Conflict of Interests**

Committee members must ensure that unless outside consultation is agreed, they maintain confidentiality with regard to all matters discussed and all materials and data made available to them in respect of their Committee-related activities. Furthermore, a Committee member must declare to the chairman of the Committee the nature and extent of any conflict of interest ("**conflict**") he/she may have as soon as reasonably practicable. The Committee member shall provide the chairman with such details of the matter as is necessary for the chairman to decide how to address the conflict, together with such additional information as the chairman may request. Where the chairman considers that any member has an actual or potential conflict of interest on a particular matter, that Committee member shall not be permitted to vote in relation to that matter. Any conflicts shall be dealt with in accordance with the Conflicts of Interest policy. The Chairman is empowered to ask any Committee member to leave all or part of a meeting, or resign from the Committee if it considers their continued involvement is no longer appropriate. No reason need be given.



## ANNEX

Matters to be independently reviewed:

- (i) LME Clear's remuneration policy to be audited on an annual basis;
- (ii) clearing operations, risk management processes, internal control mechanisms and accounts to be audited on at least an annual basis;

Matters to be independently reviewed of a risk nature:

- (iii) validation of the regular review of credit models, stress testing and back testing;
- (iv) validation of collateral and haircut policies and procedures on at least an annual basis;
- (v) review of the assessment and management system of operational risk on a regular basis;
- (vi) review of the methodologies, models and liquidity risk management framework on a regular basis;
- (vii) validation of any material revisions or adjustments to the models, methodologies and liquidity risk management risk framework;
- (viii) validation of any material revisions or adjustments to margin, default fund and other financial resources methodologies and framework for calculating liquid financial resources; and
- (ix) validation of valuation models under a variety of market scenarios.