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OCC Issues Derivatives Guidance for Bank Examiners on Futures Brokerage

The Office of the Comptroller of the Currency (OCC) announced today new guidance for examiners on derivatives related to futures brokerage activity. The guidance applies to subsidiaries that operate as futures commission merchants (FCM) registered with the Commodity Futures Trading Commission.

"One of the lessons for bank regulators from the Barings failure was the clear need for this guidance," said Douglas E. Harris, OCC Senior Deputy Comptroller for Capital Markets. "The Barings failure was due in part to a futures subsidiary with woefully inadequate internal controls. Our guidance stresses these controls as fundamental to the safe and sound operation of futures activities."

The OCC guidance includes the following:

FCM's are expected to have a risk control unit that is separate from the unit that trades in derivatives futures. Strong risk management requires that the unit assessing risk be separate from the unit taking on the risk.

That independent risk control unit is to report to executive management, the bank's board of directors or a designated management committee. The risk control unit is to periodically communicate findings to senior management and the bank's board.

When establishing the FCM's risk limits, senior bank management and the board should consider the interrelationship between risk assumed by the FCM and risk assumed by other affiliates, including the bank.

The bank's board of directors should approve aggregate risk-taking limits at least once a year. Limits should be directly related to the nature of the bank's strategies, historical performance, and the overall level of earnings or capital that the board is willing to place at risk.

The culture fostered by senior management of the FCM will directly impact the amount of reputation risk faced by the bank. Bank management should ensure that policies and procedures guiding the activities of FCM management direct and reinforce actions which are consistent with the risk profile approved by the bank's board.

To protect the bank's reputation, an FCM should implement policies and procedures which address the issues of soliciting new customers, analyzing customer creditworthiness, performing ongoing monitoring of customer accounts, and handling customer complaints.

Capital to support risk exposures of the futures brokerage subsidiary should reflect the level and complexity of the risk and not be limited to meeting minimum regulatory requirements.

The guidance also calls for an FCM to have, at a minimum, one designated compliance officer. Compliance should include standards for disclosure of risk to customers and a plan for ethics training for FCM employees.

The FCM guidance can be obtained from the OCC's automated fax system at (202) 479-0141. At the voice prompt, enter document number 1022 and 1023, or write to Comptroller of the Currency, Communications Division, Washington DC 20219.

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The OCC charters, regulates and examines America's approximately 3,000 national banks which hold 50 percent of the nation's bank assets. Its mission is to engender confidence in the nation's financial structure by safeguarding the safety and soundness of the national banking system.