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OCC Issues New Derivatives Risk Management Guidance

WASHINGTON, DC--The Office of the Comptroller of the Currency (OCC) today issued new risk management guidance on derivatives and other bank trading activities. The guidance applies to a broad range of activities, including bank transactions with hedge funds and other highly leveraged institutions, and will aid examiners in identifying design weaknesses in bank risk management systems.

"Since the summer of 1997, there has been significant volatility in global financial markets that has contributed to unexpected credit losses and declines in trading revenues," said Mike Brosnan, OCC Deputy Comptroller for Risk Evaluation. "This supplemental guidance highlights existing shortfalls in the risk management systems within financial institutions and identifies sound risk management practices that should be in place for all significant derivatives and trading activities."

The guidance, titled, "Supplemental Examination Guidance: Risk Management of Financial Derivatives and Bank Trading Activities," addresses five key risk management principles:

- o It is important to use all available technologies in risk management and to fully understand both the strengths and weaknesses of any risk management system, particularly models.
- o Risk outputs, such as the commonly used "value-at-risk" (VaR) and presettlement risk, need to be stress tested. Real markets may produce different results than those generated by risk management models. Stress testing is an essential component of the price and credit risk management process and requires the continuing attention of senior management.
- o Due diligence, careful customer selection and sound credit risk management, rather than competitive pressures in the marketplace, need to drive the credit decision process.
- o Risk oversight functions must possess independence, authority, expertise and corporate stature to provide effective early warning to senior management of negative market trends.
- o Appropriate risk control mechanisms must be in place upfront for new products and ventures into new markets.

"Not all the risk management issues addressed in this guidance apply to

every bank," said Mr. Brosnan. "We understand that these activities are concentrated in a relatively small number of banks. For those institutions, this guidance gives our examiners an overview of things that can and have gone wrong, along with current sound risk management practices that should be used by every bank engaged in these activities."

This document is available on the OCC's Web site at www.occ.treas.gov.

Related Link:

[Bulletin 99-2](#)

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The OCC charters, regulates and examines approximately 2,600 national banks and 66 federal branches and agencies of foreign banks in the United States, accounting for 58 percent of the nation's banking assets. Its mission is to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States.