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OCC Issues Examiner Guidance on Emerging Market
Country Products and Trading Activities

WASHINGTON, DC -- The Office of the Comptroller of the Currency (OCC) today issued new guidance to national bank examiners on emerging market country products and trading activities. The guidance defines emerging market countries, with some exceptions, as less developed countries that are not members of the Organization for Economic Cooperation and Development (OECD) or that have non-investment grade sovereign debt ratings.

"Trading and investment in the emerging countries makes this one of the fastest growing global financial markets," said Douglas E. Harris, Senior Deputy Comptroller for Capital Markets. "While there is potential for high returns and global diversification, we see the need to address the unique characteristics that also heighten specific elements of risk in these markets."

The guidance addresses the following areas:

Written Policies and Procedures. The guidance recommends that banks have written policies and procedures for their emerging market trading activities regarding the identification, measurement, monitoring and control of risk exposures. These policies should be endorsed by a bank's board or a committee of the board at least annually and be commensurate with the bank's activity in emerging markets.

Country Exposure. Because emerging market countries are traditionally more susceptible to political, market and social events that can directly affect the value of business activities, the guidance provides examiners with a specific framework for examining elements of country risk, a risk specific to bank activities in emerging markets.

Country Exposure Limits. Different emerging market countries can be significantly affected by the same international financial market events. The guidance urges banks to consider the interconnection risk they face doing business in these countries. The banks should assess the viability of markets on a country-by-country basis and on the basis of aggregate country exposure, and establish country exposure limits consistent with their assessment.

Aged or Stale-Date Inventory Controls. Banks may hold emerging market assets on the trading books for extended periods of time due to the periodic illiquidity of some country products and markets.

The guidance recommends that banks regularly review and evaluate these positions and subject "stale" inventory and attendant strategies to a rigorous review process.

Compensation. The guidance stresses that compensation programs should not motivate a trader to take risk inconsistent with the bank's risk appetite, or with applicable rules or regulations. It recommends that senior management consider six factors in establishing or reviewing compensation: an employee's compliance with banks policies, laws and regulations; performance relative to the bank's stated goals; relative quality of earnings (e.g. risk adjusted returns); competitors' compensation packages for similar responsibilities; an individual's overall performance; and the levels of risk inherent in and caused by relevant trading activities.

Intellectual Risk. The guidance also emphasizes that compensation programs should enable the bank to recruit and retain qualified staff. For example, if a bank's compensation program is not competitive with other institutions, it may lose its trading team and the necessary expertise to conduct business effectively.

Separation of Functions. To address the complexities of emerging market trading, the guidance stresses that front office functions and responsibilities should be independent from the back office and cautions that failure to separate front/back office functions and responsibilities may give rise to unsafe and unsound banking practices.

The guidance also addresses settlement risk, portfolio transfers, new product approval, and other emerging market trading issues.

The OCC is mailing copies of the guidance to national bank examiners and all national banks.

To obtain copies of the guidance "Emerging Market Country Products and Trading Activities," send a written request along with a check for \$6.00 per booklet to the Office of the Comptroller of the Currency, P.O. Box 70004, Chicago, IL 60673-0004.

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The OCC charters, regulates and examines approximately 3,000 national banks and 70 federal branches and agencies of foreign banks in the U.S., accounting for more than half the nation's banking assets. Its mission is to ensure the safety and soundness of the national banking system.