

**FEDERAL RESERVE BANK
OF NEW YORK**

At line. no. 8630(a)
August 27, 1979

**PROPOSED STATEMENT OF POLICY CONCERNING MINIMUM STANDARDS FOR FOREIGN
EXCHANGE AND MONEY MARKET OPERATIONS OF COMMERCIAL BANKS**

*To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:*

The Federal Financial Institutions Examination Council has invited public comment on a proposed statement of policy concerning minimum standards for documentation, accounting, and auditing of foreign exchange and money market operations (related to foreign exchange) of commercial banks. It is the intent of this statement to reinforce existing procedures and practices widely used by commercial banks in monitoring and controlling their foreign exchange and money market activities and in providing timely and accurate reports to their own boards of directors, senior management, government supervisors, and other interested parties.

The Council has requested comments on the proposed statement of policy by September 25, 1979. We would be pleased to assist you with any questions you might have on the proposed policy statement. We would also appreciate receiving copies of any comments that you provide to the Council.

A copy of the proposed statement has been sent to all affected institutions by the Federal Deposit Insurance Corporation. If for any reason you have not received a copy, we would be pleased to send you one.

Comments or requests for copies should be directed to Thomas P. McQueeney, Assistant Chief Examiner, of our Bank Examinations Department (Tel. No. 212-791-7934).

THOMAS M. TIMLEN,
First Vice President



Press Release

August 1, 1979

FFIEC-1-79

The Federal Financial Institutions Examination Council is requesting comment on a Statement of Policy Concerning Minimum Standards for Documentation, Accounting, and Auditing of Foreign Exchange and Money Market Operations of Commercial Banks. It is the intent of this statement to reinforce existing procedures and practices widely used by commercial banks in monitoring and controlling their foreign exchange and money market activities and in providing timely and accurate reports to their own Boards of Directors, senior management, government supervisors, and other interested parties.

The proposed policy statement was published in the Federal Register on July 27, 1979, with a comment period extending to September 25, 1979.

A copy of the policy statement is attached.

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RECEIVED

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P. A. V.

ANSWERED _____
ATTENDED TO _____

Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board,
National Credit Union Administration, Office of the Comptroller of the Currency

FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL
(FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL ACT
OF 1978, 12 U.S.C. 3305)

COMMERCIAL BANKS

Notice of Proposed Statement of Policy Concerning Minimum Standards for Documentation, Accounting, and Auditing of Foreign Exchange and Money Market Operations of Commercial Banks.

AGENCY: Federal Financial Institutions Examination Council

ACTION: Proposed policy statement

SUMMARY: This proposed statement of standards for the documentation, accounting, and auditing of foreign exchange and money market activities of commercial banks was prepared by the Task Force on Supervision of the Federal Financial Institutions Examination Council. It is intended to reinforce existing procedures and practices widely utilized by commercial banks in monitoring and controlling their foreign exchange and money market activities and in providing timely and accurate reports to their own Boards of Directors, senior management, government supervisors, and other interested parties.

EFFECTIVE DATE: Written comments must be received on or before September 25, 1979, (60 days from publication in the Federal Register).

ADDRESSES: Comments should be addressed to Mr. Paul M. Homan, Chairman, Task Force on Supervision, Federal Financial Institutions Examination Council, Washington, D. C. 20219.

FOR FURTHER INFORMATION CONTACT:

Mr. Hugh W. Conway, Review Examiner
Federal Deposit Insurance Corporation
550 17th Street, N.W., Room 5100
Washington, D. C. 20429
(202) 389-4349

SUPPLEMENTARY INFORMATION: The following standards are proposed to provide bank management with timely and accurate details of their banks' foreign exchange and money market activities and to provide government supervisors and other interested parties with reasonably uniform minimum data. It must be recognized that the standards contained herein represent the current judgement of the Federal Financial Institutions Examination Council as to the minimum requirements for banks' foreign exchange and money market operations and should not be perceived as all encompassing in terms of those policies and procedures which are expected to be found in the more active participants in these markets. Most commercial banks have adequate systems and procedures to monitor and control their foreign exchange activities. Many banks have systems that exceed the requirements of this statement of standards. Nevertheless, it is believed that these standards will prove useful both to bank management and the bank supervisory agencies in promoting the safety and soundness of individual banks as well as the banking system as a whole.

The standards represent a consensus on certain minimum elements that should be included in a bank's system for documenting, controlling, and monitoring its foreign exchange activities. The standards will serve as a basis by which management, auditors, and supervisory authorities can measure and evaluate the individual bank's system for controlling and monitoring its foreign exchange activities.

DRAFTING INFORMATION: The principal drafter of this document was Hugh W. Conway, Review Examiner, FDIC.

PROPOSED POLICY STATEMENT

STANDARDS FOR THE DOCUMENTATION OF TRADING AND MONEY

MARKET POLICY

Each bank engaged in foreign exchange trading should have written memoranda that provide a thorough overview of the goals and policies established by senior management. The memoranda should describe the scope of trading activity authorized and types of services offered. It should also describe the trading limits, controls, and other instructions delegated to trading personnel at each office of the bank.

As a minimum, the bank's policy should include limits with respect to:

- 1) Net positions by currency;
- 2) Maturity distribution of foreign currency assets, liabilities, and contracts;
- 3) Outstanding contracts with individual customers and banks;
- 4) Daily settlements with individual customers and banks; and
- 5) Total outstanding contracts, spot and forward.

The bank's trading policy should provide for reporting procedures which ensure staff adherence to policy directives and keep senior management informed of the size and scope of trading at all the bank's offices. Banks vary in the detail of reporting required from their trading offices; however, each bank's head office should maintain current and complete records that indicate exceptions to limits, controls, and instructions delegated to individual trading offices.

When a system of reporting by exception is used, the limits delegated to each trading office should closely reflect the actual or anticipated range of trading at each office. The range and volume of trading by trading offices should be reviewed periodically, and those limits that do not reflect present or anticipated outstandings should be reduced. The limits should not be deliberately set too high so as never to be exceeded.

While recognizing the existence of delivery risk, some banks do not believe that it is necessary to establish limits and formal reporting procedures in order to satisfactorily monitor this exposure. These banks choose to weigh delivery risk in their determination of individual customer limits for outstanding contracts. As a minimum, each bank should have documentary evidence that a customer's delivery exposure is being reviewed by responsible account and trading officials. Every bank should have the capability to readily report delivery exposure with customers and banks.

The bank should have a written policy for trading with customers affiliated with the bank or with members of the Board of Directors. The terms and conditions of foreign exchange contracts should not vary materially from similiar transactions with nonrelated companies. The policy should include any arrangements for holding positions or executing contracts for the account of other offices, banks, or outside parties.

STANDARDS FOR PREPARATION AND MAINTENANCE OF ACCOUNTING

INSTRUCTIONS AND THE ESTABLISHMENT OF INTERNAL CONTROLS

Each trading office should have a complete and current set of memoranda available explaining the information generated from the accounting system. The general and subsidiary ledger accounts affected by the trading and funding activities and any daily, weekly, and monthly procedures used to revalue trading and funding positions should be described.

The memoranda should describe the accounting and internal controls incorporated in the system to ensure the reporting of current and complete data on trading and funding activities, to prevent misappropriation of funds, and to preclude concealment of unauthorized transactions.

The accounting and internal controls should include as a minimum:

- 1) A strict segregation of duties for trading, operational (recordkeeping), and custodial (paying and receiving) personnel;
- 2) A procedure for determining the order, date, and time trading personnel entered into individual contracts. A time stamping of dealing slips would be satisfactory (see item 6b);
- 3) The identification of "financial swap" contracts;
- 4) The preparation of outgoing confirmations that include:
 - a) date of transaction, date of preparation if different from transaction date, and date of value or maturity date;
 - b) amounts of the currencies traded, accepted, or placed, and the applicable rate; and

- c) liquidation instruction, if available, and reference number;
- 5) A holdover register to record trades made but not posted to the bank's ledgers at end of day, the identification of such contracts as "hold-over" items, and their inclusion in the trader's day-end position reports to management;
- 6) Sequentially numbered contract forms that are:
 - a) kept under control,
 - b) prepared in the same order as the dealing slips, and
 - c) identified as to date of preparation if different from transaction date;
- 7) A procedure under which contract confirmations are sent and received by the operations staff only (not the trading staff) and the maintenance of a confirmation exception log that:
 - a) records every exception between an incoming confirmation and the bank's own records regardless of disposition, and
 - b) is reviewed at least weekly by an operations officer,
- 8) A daily reconciliation of the dealer's position sheets with the bank trading and funding positions as recorded in the general ledger; and
- 9) Information on all overdraft charges, brokerage bills, authorizations for payments within the last 12 months, and retention of all foreign exchange telex tapes for the past 12 months.

MINIMUM STANDARDS FOR THE AUDIT OF FOREIGN EXCHANGE AND

MONEY MARKET ACTIVITIES

The following minimum procedural and reporting standards are applicable to audits of foreign exchange and money market departments by bank internal auditors.

The internal auditors responsible for the audit of foreign exchange and money market activities should report to the Board of Directors or a committee thereof. Correspondence between the Board and the auditors should indicate that the directors are being properly informed of trading and funding activities.

Audit reports and supporting workpapers should be readily available for review by examination personnel. Copies of all audit reports for subsidiary and branch foreign exchange departments should be available either at the head office or at an office readily accessible to examination personnel.

The internal auditor's report and workpapers should include:

1) A review and critique of the bank's accounting memoranda. This review should indicate exceptions to the prescribed procedures and whether staffing is adequate for the needs of the trading operations. The audit workpapers should include the description of the accounting process prepared by the auditor, including organization charts, flow charts, and internal control questionnaires.

2) A review and assessment of the internal controls incorporated into the accounting system and the effectiveness of these internal controls. Every audit should include an appraisal of internal controls. The review should include a listing of all the internal controls incorporated into the accounting system and the testing undertaken to evaluate the effectiveness of these controls.

Auditors will be expected to report where any of the minimum internal controls listed above are not incorporated in the accounting system or are not operating effectively.

3) The extent of the auditor's substantive tests of amounts included in financial statements as well as in reports to senior management and regulatory agencies.

4) The auditor's review of compliance by trading staff with the bank's policies and directives.

The audit reports of public accounting firms engaged to audit a bank's foreign exchange activities, any management letters, as well as the scope of audit, should be readily available to examination personnel. These documents should include a review and a critique of the bank's formal accounting instructions for foreign exchange operations, exceptions to prescribed procedures, and the adequacy of prescribed procedures and staffing.

Approved June 7, 1979
By order of the Council.

FEDERAL FINANCIAL INSTITUTIONS EXAMINATION
COUNCIL

(Signed) Lewis G. Odom

Lewis G. Odom
Executive Secretary (Acting)