

AT 1023a
1

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, N.Y. 10045

AREA CODE 212 720-6375

CHESTER B. FELDBERG
EXECUTIVE VICE PRESIDENT

March 20, 1992

**TO THE CHIEF EXECUTIVE OFFICERS OF ALL BANKING ORGANIZATIONS
IN THE SECOND FEDERAL RESERVE DISTRICT:**

In carrying out our bank supervisory responsibilities, we have become aware in recent months of several instances of basic internal control weaknesses in the trading operations of both domestic and foreign banks. The problems have surfaced in a number of trading activities, including foreign exchange spot, forward, and options transactions, interest rate products, various securities, and other traded assets. The deficiencies noted have related to such fundamental control principles as: the separation of duties between trading and back-office personnel; the independent sourcing of price, interest rate, exchange rate and volatility factors utilized in the revaluation process; and management oversight to assure that (1) trading limits are set at appropriate levels and are not exceeded, and (2) the resolution of disputed transactions, the relationship with brokers, and the conduct of trading personnel are appropriately monitored. In this latter regard, a number of recent developments at both domestic and foreign banks suggest that more attention is needed to assure that proper business practices are being followed in all trading areas.

Sophisticated trading strategies and complex instruments by their very nature require robust risk management and controls. We request all banking organizations to review the adequacy of their existing accounting and control procedures for trading activities and rules of conduct applicable to trading personnel and to implement any necessary changes promptly. Banking organizations which fail to maintain appropriate internal control environments and high standards of business practice by their employees risk supervisory criticism but, more importantly, are vulnerable to financial loss, fraud, and damage to their reputation and market standing. We intend to focus more supervisory attention on these areas in the course of our ongoing examination programs. Moreover, we are considering the need to provide banking organizations with further guidance on acceptable standards governing their various trading activities.

(Over)

I urge you to personally assure yourself that proper controls and management safeguards are in place and adequately enforced, and, if not, to see to it that prompt remedial actions are taken. Questions or comments regarding these matters may be directed to Kathleen A. O'Neil, Vice President, International Banking Department (212-720-5371) or Robert A. O'Sullivan, Vice President, Domestic Banking Department (212-720-5692).

Yours sincerely,



Chester B. Feldberg
Executive Vice President