

PRINCIPLES FOR THE MANAGEMENT OF OPERATIONAL RISK IN MARKET-RELATED ACTIVITIES

GOVERNANCE MECHANISMS

Principle 1. The Board of Directors and Senior Management should be aware of the operational risks, actual or potential, affecting market-related activities. It should develop and maintain an organisational structure, internal controls and a reporting system suitable for the identification, assessment, control and monitoring of operational risks in market-related activities.

Principle 2. The Board of Directors and Senior Management should promote, particularly in the front office, a culture designed to mitigate operational risks in market-related activities.

Principle 3. Senior Management should ensure that they, and the staff in the control and support functions, have the appropriate understanding, skill, authority and incentive to provide an effective challenge to traders' activities.

Principle 4. Operational risk should be taken into account in setting objectives for, and in the assessment of, an individual's or business unit's performance in market-related activities.

Principle 5. Proactive behaviour against actions which are considered as fraud or suspicious activities in market-related activities should be a key element of internal controls and reporting systems.

INTERNAL CONTROLS

Principle 6. Traders should initiate transactions only when these are compliant with their set terms of reference. Minimum standards for the initiation and conclusion of transactions should be followed.

Principle 7. Documentation requirements for trading activities should be properly defined. Legal uncertainties should be minimised so that the contracts are enforceable as far as possible.

Principle 8. As a general rule, transactions should be initiated and concluded in the trading room and during trading hours.

Principle 9. All relevant positions, cash flows and calculations associated with a transaction (for example trading book positions, profits and losses and contingent cash flows) should be clearly recorded in the institution's IT systems with a documented audit trail.

Principle 10. Institutions should ensure that they have an appropriate framework of controls over the relationships between traders and their market counterparts.

Principle 11. Confirmation, settlement and reconciliation processes should be appropriately designed and properly executed.

Principle 12. Institutions should ensure that their margining processes are working properly and that any changes are reconciled with the relevant positions on their books.

Principle 13. Sources of operational risks in market-related activities should be properly identified and monitored with the appropriate level of scrutiny, intensity and timeliness.

Principle 14. The nominal value of transactions/positions should be kept under strict control for monitoring operational and counterparty risks through the definition of pertinent limits and/or participation in initiatives for the novation of contracts.

Principle 15. Information systems in the trading area should be appropriately designed, implemented and maintained so as to ensure a high level of protection in market-related activities.

INTERNAL REPORTING SYSTEM⁽¹⁾

Principle 16. The operational risk reporting system for market-related activities should be designed to generate appropriate warnings and should alert management when suspicious operations or material incidents are detected.

Principle 17. Institutions should ensure the quality and consistency of their internal reports and that they are appropriate to the needs of the recipients for which they are intended.

Credit institutions are expected to follow the CEBS Guidelines on the management of operational risk in market-related activities for a more comprehensive treatment of risks emanating from market related activities.

⁽¹⁾ This Section, while drafted for market-related activities, is generally valid and applicable to any other business area of an institution.