

BANKING COMMISSION

Brussels, 17 April 1990

CIRCULAR B 90/1 TO BANKS AND S 90/2 TO PRIVATE SAVINGS BANKS

Dear Sirs,

The Banking Commission has deemed it necessary to change its rules relating to the organization and monitoring of foreign exchange transactions (Circular to banks No B 76/1 of 27 February 1976, incorporated as pages 301 to 308 in the Banking Commission's manual entitled "Commission Bancaire. Lois, arrêtés et règlements. Mesures d'application. Banques. Tome I"), taking account of technological developments in the credit institutions and of the emergence of new financial transactions.

At the same time, it has been possible to incorporate in these rules a number of Circulars which had been sent to the credit institutions in the past few years.

Please find enclosed the amended and coordinated text, entitled "Rules relating to the internal organization and the monitoring of credit institutions' transactions on the money and foreign exchange markets".

These rules apply both to banks and private savings banks. For the banks, they replace the text in pages 301 to 308 of the above-mentioned manual.

Yours faithfully,

(signed)


The Chairman

Enclosure: one

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**RULES CONCERNING THE INTERNAL ORGANIZATION AND THE MONITORING
OF CREDIT INSTITUTIONS' TRANSACTIONS ON THE MONEY AND FOREIGN
EXCHANGE MARKETS**

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1. GENERAL CONSIDERATIONS

1.1. Transactions covered

By "transactions on the money and foreign exchange markets" is meant transactions which are traditionally concluded by the dealing room of a credit institution. They mainly comprise loans/borrowings in connection with the management of the cash holdings in Belgian francs and foreign currencies, both on the interbank market and with customers, foreign exchange transactions (spot or forward purchases and sales of foreign currencies), and other off balance sheet foreign currency and/or interest rate transactions.

The term "transactions in foreign currencies" has been deliberately avoided, since, firstly, some of the Belgian franc business also takes place on the money and foreign exchange markets and secondly "foreign currency business" also relates to transactions such as foreign currency lending, trading in foreign currency securities and investment management.

The particular vigilance which is needed in connection with activities on the money and foreign exchange markets and which justifies the present rules results from the size and diversity of the risks which are associated with these transactions, from their sometimes highly technical nature, from the speed with which new instruments appear in the market and from the often very large size of the transactions.

The development of new types of off balance sheet transactions (forward rate agreements, financial futures, currency and interest rate swaps, currency options, interest rate options, forward deposits, exchange rate agreements, etc.) offer the institutions more possibilities than before of

covering themselves adequately against the various types of risks. It should be noted, however, that these transactions, if used imprudently or as a trading instrument, may entail additional risks or increase existing risks.

1.2. Types of risk

A number of risks of different types are associated with a credit institution's activities on the money and foreign exchange markets. For the record and by way of background, a description of the main types of risk is given below.

1.2.1. Exchange rate risk

A major type of risk - and the one which features most in the field of foreign currencies - is the exchange rate risk. This is the risk of losses that a credit institution may suffer as a result of unfavourable movements in exchange rates during a period when it takes an uncovered position in an individual currency.

This uncovered position can be analysed in different ways, each of which must, however, be based on a common concern, namely the detection and taking into account of all the institution's current transactions which have or may have an effect on the exchange rate risk. These transactions, of course, do not take place exclusively in the assets and liabilities of the balance sheet; they are also to be found - often to an increasing extent - off the balance sheet.

The position in a currency can thus be defined in very simplified fashion as being the total of the asset items, plus all the amounts receivable in this currency arising from spot and forward transactions in course of liquidation. Additional refinements are essential, however, in order to take account of the particular effect that certain transactions or items may have on the exchange rate risk. Thus, the (conditional) effect of a currency option is different from the (unconditional) effect of a forward exchange transaction. Similarly, fixed assets, interest receivable/payable etc. may require special treatment and it might be useful to make a distinction between a position the management of which is the dealing room's responsibility and a position which arises from more structural factors.

The chief way of monitoring the exchange rate risk consists in calculating the overall position in foreign currencies. This position is obtained through the algebraic sum of the net positions for all currencies combined, in other words with offsetting of the short positions in certain currencies against the long positions in others. An overall position calculated in this way does not, however, give a true picture of the size of the exchange rate risk incurred by the institution. It simply indicates to what extent a portion of the liabilities in national currency is allocated for the holding of foreign currency assets, all currencies combined (overall long position) or, conversely, to what extent a portion of the assets in national currency is financed by foreign currency liabilities, all currencies combined (overall short position). In other words, the overall position constitutes the counterpart of what is usually called "the position in national currency".

The real exchange rate risk must, however, be calculated for each currency, since any change in the value of a currency in which a position has been taken leads to either a loss or a gain in the inventories drawn up in national currency. The "total" foreign exchange position may be calculated in different ways: by adding up, without offsetting, the long and short positions of individual currencies, or by adding up the long and short positions only.

1.2.2. Interest rate risk and liquidity risk

Even in the absence of a foreign exchange position, the position in a currency may contain imbalances when it is broken down into its successive maturities, since not only all the currencies but also the maturities (or fairly closely defined groups of maturities) need to be evaluated separately given that their prices (exchange rates and/or interest rates) are different and may move differently.

A dual risk, i.e. an interest rate risk and a liquidity risk, is regarded as attaching to this imbalance in the structure of maturities.

This distinction can be explained by means of a simple example. An institution borrows at three months in a particular currency and on-lends the borrowed funds at six months in the same currency with a favourable intermediation margin. Disregarding the problem of interest not yet accrued and of the intermediation margin, this institution does not have

a foreign exchange position in the currency concerned. The life of the assets and liabilities, however, is not identical. After three months, the institution will have to go to the market for a new loan in order to continue the financing of its six-month investment. It runs the risk of not finding the necessary foreign currency at the moment (liquidity risk) and of having to pay a rate of interest which has increased in the meanwhile (interest rate risk).

The importance of the liquidity risk is played down by some who consider that an institution will always in theory be able to borrow or purchase the necessary amounts in the market: it is sufficient to pay the price ruling on the day. Looked at in this way, the risk to which an institution exposes itself in the event of maturity mismatching is solely an interest rate risk. However, the amounts for which the forward exchange transactions and the loans/borrowings are concluded are often high. The institutions must therefore ensure that the cash needs which arise from a maturity mismatch remain at a level which enables it to continue to find counterparties that will lend it the necessary funds. Furthermore, an institution must, more generally, refrain from contracting loans of a size which could damage its reputation on the market.

It can also be seen from the foregoing that the liquidity risk requires not only a short-term approach ("cash risk") but also a long-term approach, which could be defined as the monitoring of the "maturity mismatching risk". The latter therefore refers to the risk of financing long-term assets by funds of shorter maturity.

The interest rate risk can also be looked at from two points of view. One examines the risk already described above which arises from losses in the future flow of net interest income, resulting from unfavourable movements in interest rates (income risk); the other examines the "market risk", i.e. the possible risk of an immediate change in the book value of marketable instruments resulting from unfavourable movements in interest rates.

1.2.3. Risk of counterparty default

Another risk of which account has to be taken is that of counterparty default.

In the context of the present instructions reference is made here not only to the **credit risk** associated with loans/borrowings in national or foreign currency, but in particular also to the **settlement risk** inherent in transactions where the two parties must at some future time simultaneously effect a payment, e.g. in the case of foreign exchange transactions.

Foreign exchange transactions involve firstly the risk of insolvency of the counterparty on or before the day of liquidation of the transaction, but in any case before the institution itself has fulfilled its commitment (**credit risk**). This risk is present throughout the duration of the contract. Such counterparty insolvency would probably upset the balance of the overall position that the institution had achieved. The institution runs the risk of having to cover itself again - with another counterparty - possibly on less favourable terms.

Secondly, they involve the risk of non-fulfilment by the counterparty of its contractual commitment (e.g. because of the insolvency of this counterparty or its payment agent) whereas the institution itself has already fulfilled its commitment (**settlement risk**). The risk here amounts to the total value of the contract.

One aspect of the payment risk is the **time-zone risk** arising from the fact that the foreign exchange markets operate round the clock. Because of the time lags which can occur between liquidation in a particular currency in a particular financial centre and liquidation in another currency in another financial centre, an institution may in this case also run the risk for the whole amount of the contract if the counterparty or the payment agent becomes insolvent in the meantime. Thus, payment orders relating in particular to Asian currencies often have to be sent on the day preceding receipt of the amounts due in non-Asian currencies.

1.2.4. Country risk

Lastly there is the **country risk**. In this connection, it is sufficient here to refer to the Banking Commission's circulars on this subject.

1.3. Need for rules relating to organization and monitoring

Because of the various aspects of the risks inherent in transactions on the money and foreign exchange markets (cf. 1.2.), credit institutions must observe a number of basic principles and methods of application relating to the organization, supervision and monitoring of their activities in this regard.

These rules are designed to help protect the assets and, more generally, the equity of credit institutions, and to ensure that their internal and external information systems are reliable and that business is conducted in an orderly, effective and prudent manner (cf. the definition of internal supervision of credit institutions; Banking Commission Circular of 6 April 1987).

The rules are a continuation of the recommendations which have been made at international level to the credit institutions and their supervisory authorities. Reference is made here in particular to the regulations (*) which the Banking Commission has sent in this connection in the past to credit institutions established in Belgium and/or to authorized auditors:

- Circular B 82/3 of 25 March 1982 to banks, enclosing a free translation in French or in Dutch of the document entitled "Supervision of banks' foreign exchange positions", issued by the Committee on Banking Regulations and Supervisory Practices";
- Circular of 29 December 1985 to authorized auditors, enclosing firstly the text of a resolution issued by the Governors of the Group of Ten and Switzerland concerning off balance sheet transactions (this resolution was also sent to the Belgian professional associations of the banks and savings banks) and secondly a note concerning the problems connected with new financial instruments;
- Circular of 17 March 1986 to banks and savings banks, enclosing a document entitled "The management of banks' off balance sheet exposures: a supervisory perspective", issued by the Committee on Banking Regulations and Supervisory Practices".

Section 2 below deals with the basic principles to be observed. Section 3 examines in more detail the practical methods of application and the specific rules designed to implement the basic principles.

- (*) The present rules constitute a coordinated set so far as transactions on the money and foreign exchange markets are concerned. However, the texts quoted continue to be useful in this connection as a source for the institutions to refer to (e.g. the glossaries annexed to these texts).

These principles and methods of applications do not, of course, affect the institution's obligation to comply with any legal or regulatory restrictions or authorization procedures to which it may be subject by virtue of its status.

2. BASIC PRINCIPLES

2.1. Trial period applicable to new transactions

As for any area of activity in which a credit institution wishes to operate, it is necessary for the highest management body to give its authorization before the actual commencement of operations on the money and foreign exchange markets. For a trial period an adequate organization system should be put in place and tested so that the transactions can be carried out within a well thought out framework of limitations and monitoring and are supported by an effective administration and accounting system.

2.2. Responsibility of the highest management body

The credit institution's highest management body shall be responsible for policy concerning transactions on the money and foreign exchange markets and shall decide whether and by what means the institution will develop an activity beyond what is necessary to enable customers' needs to be met.

This responsibility shall include in particular the setting of guidelines and objectives for the activity, their organization and control and their supervision.

In this connection, the highest management body shall take account of the general policy determined by the institution's highest administrative body or, in the case of a branch of a credit institution governed by foreign law, of the restrictions imposed by the head office.

A member of the highest management body shall be responsible for implementing the policy laid down. He shall inform his colleagues regularly of what he is doing and shall recommend any necessary corrective measures. If necessary, he shall put proposals to them, setting out the grounds on which they are based, concerning a change of policy. He shall liaise with his colleagues responsible for the institution's accounts, organization and internal audit in order to provide for the needs and effects that these transactions may entail for these departments.

2.3. Internal limits

Quantitative limits shall be imposed by the highest management body according to the nature of the transactions and the risks they entail. These limits must take account of the types of risk referred to in section 1.2. above and be designed to keep the risks incurred within bounds which safeguard the institution's capital base.

2.4. Separation of functions; procedures; rules of conduct; reporting; internal monitoring and audit

The highest management body shall draw up the organizational plan relating to the institution's activities on the money and foreign exchange markets.

A system of strict separation shall be applied between the different functions and responsibilities, i.e. principally between, on the one hand, the persons or departments in charge of or responsible for concluding the transactions and/or determining the course of action to be followed from day to day in accordance with the policy laid down by the highest management body and, on the other hand, the persons or departments in charge of or responsible for the administration and accounting treatment and the permanent critical supervision governing the transactions.

The organizational plan must also maintain separation between the persons or departments mentioned above and the persons in charge of or responsible for the credit analyses and the internal audit.

The allocation of signing powers shall take account of these separations.

Internal procedures and rules of conduct relating to the dealers and the practical functioning of the dealing room, to the subsequent carrying out of the transactions (permanent supervision, administration, accounting treatment, reporting) and to the internal audit must be laid down by the relevant member of the highest management board or his deputy.

Monitoring tasks shall be defined in such a way that monitoring, particularly that of compliance with instructions, can be exercised without involvement of the dealers (and the persons responsible for determining the course of action to be followed each day). Without prejudice to hierarchical monitoring and the procedures for permanent supervision integrated into the organization, activities will also be the subject of inspections carried out by persons who are members of the internal audit department.

2.5. Appointment of foreign exchange dealers; powers

The highest management body shall appoint the dealers and determine the limits of their powers. The Banking Commission shall be informed both of the appointments and voluntary resignations and of the dismissals of dealers who are authorized to carry out transactions for relatively large amounts.

3. METHODS OF APPLICATION

Each institution must apply the basic principles set out in section 2 in whatever way suits it best, using specific methods of application. The methods may differ according to the volume and nature of the institution's activities and its organizational structures.

Given below are some methods of applications which may be considered in this connection. Supplemented or adapted according to the volume and nature of the institution's activities and its organizational structures, they must, looked at as a whole, ensure compliance with the basic principles mentioned above.

Each institution must, of course, continually re-examine the suitability of the measures taken, bearing in mind rapid changes in the environment such as technological developments and the emergence of new markets and products.

Moreover, the need to implement the basic principles to be complied with applies not only to the organization and supervision of transactions effected in the head office in Belgium and in any dealing rooms in Belgium, but also to the organization and supervision of transactions effected in the institution's foreign establishments.

The methods of application set out below follow the same pattern and numbering as the basic principles referred to in section 2.

3.1. Trial period applicable to new transactions

A credit institution may not embark on new activities or conclude new types of transactions without the express prior permission of the highest management body. This rule shall also apply to major changes in the nature of the

institution's activities, e.g. where it decides not only to carry out hedging transactions but also to conclude trading transactions, where it intends to act as market maker, etc.

Furthermore, new types of activity need to be undertaken gradually and with necessary care. For this reason the institution should introduce a trial period for any new type of transaction in which it wishes to be active. During this trial period, only a small number of new transactions, of relatively limited size, should be concluded; they should be monitored very closely by the highest management body so that the institution, without exposing itself to excessive risks, can check whether the internal instructions which it has drawn up and the organizational control of these new transactions are functioning effectively. ✓

3.2. Written policy

The policy pursued must be laid down in writing by the highest management body and must be examined critically at regular intervals with regard to its suitability. The policy thus formulated should take particular account of the guidelines and desired objectives relating to the transactions, their organization and control and their supervision.

If the highest management body sets the dealing room profitability targets, they should be fixed at a level which is compatible with providing a reasonable degree of security for the transactions and which does not give rise to the taking of risks that could adversely affect the institution's solvency, profitability or liquidity.

3.3. Quantitative limits

The existence of risk positions cannot be totally ruled out in an institution which carries on a significant amount of business on the money and foreign exchange markets.

However, the institution must be fully aware of the different types of risks it runs in this connection (cf section 1.2.) and in any case must keep them within the limits which safeguard its capital base.

Quantitative limits must therefore be set by the highest management body.

The limits should distinguish between, on the one hand, the limits regarding the volume of business that may be undertaken and, on the other hand, the risk positions that may be taken.

The limits regarding volume of business may for example relate to the different types of transaction that the institution will carry out, to the ratio of total balance sheet transactions to off balance sheet transactions, to the ratio of total transactions in Belgian francs to total transactions in foreign currencies, etc.

The limits regarding risk positions must in particular take account of the types of risk mentioned in section 1.2. and the different situations which can give rise to the types of risk referred to.

Each limit shall be set at a level which takes account of the financial position (solvency, profitability and liquidity) of the institution and of the possibility of a simultaneous adverse trend in the risk factors concerned. In this connection, the necessary consistency between these limits relating to areas of activity and their effect on the overall picture presented by the institution's financial situation should not be lost sight of.

The limits shall be laid down in writing and formulated clearly and unambiguously. If necessary, they shall be accompanied by quantitative examples in order to explain the method of calculation. They must be made known to all members of staff to whose activities they relate. The written internal instructions and the procedure descriptions for the dealers (cf 3.4.2.) shall include a definition of the limits in force. If the limits are changed, the instructions shall be updated without delay.

Any foreign subsidiaries and branches of the institution must be included in the system of limits, e.g. by giving each entity sub-allocations of the limits relating to each type of transaction and risk which appears in these entities' books.

If the institution has more than one dealing room in Belgium, the same principle as that stated in the preceding paragraph shall apply.

The limits shall not only relate to the institution's overnight position but also to the situation during the day (intra-day limits).

If the institution makes a distinction between hedging and trading transactions, it must clearly define the criteria which a hedging transaction must meet.

The necessary procedures must be drawn up where necessary in order to determine a policy on the authorization of deviations from the limits imposed. These procedures must in particular define the arrangements applying where the limits are exceeded (amount, duration, possibility of repetition, need for express prior authorization by line management, reporting rules etc).

3.4. Separation of functions; written descriptions of procedure

The principle of separation of functions must be applied with the utmost rigour. A change in the environment factors (e.g. increasing automation and the related possibilities of integrated processing of transactions) may influence the way in which separation is actually achieved, but does not affect the need to observe the separation of function principle itself.

The way in which the various stages of the transactions are carried out must be defined in written descriptions of procedure.

3.4.1. Organization plan

In general, the institution's organization plan must in principle maintain at the highest level possible the separation of the lines of command relating, on the one hand, to the operational side of the transactions and, on the other hand, to their processing and monitoring.

In a typical organization the operational line includes the following functions: conclusion of transactions (the dealers), local management (the head of the dealing room), senior management responsible for activities on the money and foreign exchange markets.

The processing and monitoring line principally includes the permanent critical supervision governing the transactions, and their administrative and accounting treatment.

In order that each of these functions can fulfil its role with the necessary degree of independence, it is not possible, for example, to allow both the dealing room and the department responsible for the permanent critical supervision and the administrative processing of transactions (back office) to appear in the organization plan under, or to be managed de facto by, the same person. Nor can this department be allowed to come under the management of the persons in charge of or responsible for determining the day-to-day policy to be followed.

3.4.2. Rules concerning the conclusion of transactions

With regard to the conclusion of transactions, each institution must lay down certain permanent internal written rules concerning the activities of the dealers and the practical functioning of the dealing room.

3.4.2.1. Rules concerning the activities of the dealers

As regards the activities of the dealers, these rules shall in particular impose a ban on acting either directly or indirectly for their own account or for account of other members of staff of the institution. This ban does not mean, however, that a dealer or another member of staff cannot act as a customer of the institution - the proviso being that the relevant internal organizational and monitoring procedures are observed.

Transactions must be concluded exclusively on terms which are representative of the market's situation at the time.

This representativity rule must also be observed in the case of extensions of contracts. In particular, the rate applied for the extension of a forward exchange contract must not be based on the rate relating to the maturing contract. In accordance with usual practice, where a contract is extended it is the spot rate ruling at the moment of extension which must be used as the reference rate for determining the forward rate applying to the extension contract. Where, in connection with a maturing forward exchange transaction, a customer wishes to extend his position, this extension must be effected in accordance with the rules stated above. Extensions of position which are effected under other rules and which, in particular, may result in the loan granted by the institution to finance the customer's loss being converted into an off balance sheet credit risk, must be avoided.

Without prejudice to the comments in 3.4.2.3. below concerning "pass-through transactions", dealers must not be allowed to conclude transactions with retrospective effect (date of conclusion and/or value date).

3.4.2.2. Rules concerning the organization and functioning of the dealing room

As regards the organization of dealing activities and the practical functioning of the dealing room, the instructions or measures taken concerning organization must in particular include the following rules.

Each dealer must have a ranking in the dealing room's organization plan. Clearly defined delegations of authority with regard to signing and decision-making powers (concerning the execution of transactions and the taking of positions) must be laid down for each dealer or group of dealers. The signing powers, for example, should avoid making it possible for one or more persons in the operational line (cf 3.4.1.) to commit the institution through their signature, without the signature of a person in the processing and monitoring line.

As far as possible, the function of dealer shall be a full-time job, incompatible with other functions in the institution. If, because of the small size of the institution, other tasks are nevertheless given to the dealers, they must not affect observance of the basic principles concerning separation of functions.

A dealer's pay shall be fixed by the highest management body and only a limited part of it may take the form of a variable portion the size of which will depend on the achievement by the dealer, a group of dealers or the dealing room as a whole, of predetermined profitability targets.

It may be that the chief dealer does not conclude transactions himself. In large dealing rooms this is in fact preferable. His task will then consist of giving specific advice and instructions and supervising the activities of his staff. In any event, persons of a higher rank than his and those who do not work under his management, may not conclude transactions.

All transactions shall be concluded in the dealing room in accordance with a clearly defined timetable. This rule may only be waived in exceptional circumstances, subject to the prior agreement of the highest management body and provided that appropriate organizational and supervisory procedures are applied in such a way as to ensure the proper functioning of the institution's activities in all circumstances. These procedures must also limit the extent to which exceptions can be made to this rule (e.g. only transactions aimed at reducing a position taken), appoint the persons who may conclude transactions and lay down specific rules for the immediate recording of transactions.

The necessary measures must be taken to protect physical access to the dealing room and to prevent unauthorized persons from gaining access.

The actual conclusion of each transaction must be recorded (recording of telephone calls on magnetic tape, telex, electronic transmission systems etc). This information must be kept for a sufficient length of time (physically separate from the dealing room) and be able to be used without restriction for supervisory purposes.

The dealing room shall at all times keep up to date the statement showing its risk positions.

The solvency analysis (assessment of the risk of counterparty default) shall not be the responsibility of the dealing room but of the credit analysts (credit department, interbank relations department etc), who for this purpose shall have at their disposal the necessary financial documentation. The dealers shall, of course, notify the chief dealer and the credit analysts concerned without delay of the information obtained in the market or from their contacts relating to a market participant's business activities. If the dealing room executes transactions at the customer's risk (e.g. under an investment management or foreign exchange position contract), the necessary safeguards must be taken in advance (e.g. placing of a deposit as margin) in order to reduce the credit risk.

As soon as they have been concluded, all transactions must be classified according to the criteria which determine their accounting treatment. The necessary safeguards (ex ante instructions and ex post supervision) must be taken in order to prevent measurement of the risks incurred and/or the results on the basis of the accounting data from being affected as a result of incorrect classifying, whether intentional or not, of transactions by the dealers.

Special procedures must be used where a completed transaction is changed or cancelled.

3.4.2.3. Rules concerning relations with intermediaries and counterparties

The credit institution's highest management body shall ensure that the dealers are subject to a rigorous code of conduct as regards their relations with intermediaries (e.g. foreign exchange brokers) and counterparties.

The "Guide des pratiques du marché" which was drawn up in 1977 by the Belgian Bankers Association for foreign exchange brokers and for dealers, and similar codes of conduct drawn up abroad (e.g. the London Code of Conduct), may serve as guidelines.

The code of conduct must, in particular, be designed to safeguard the necessary independence and neutrality between the dealers and the intermediaries or counterparties (prohibition on incentives for the dealer to give preference to working with a particular broker or counterparty, and vice versa; prohibition on the dealer receiving commission or any direct or indirect benefit from brokers or counterparties, etc).

Dealers shall notify the management immediately an intermediary or counterparty attempts to breach such codes of conduct.

"Pass-through transactions" (i.e. transactions where a credit institution stands as a counterparty between two other institutions which, for example, want to avoid exceeding their internally imposed limits per counterparty) may only be concluded in exceptional circumstances and subject to compliance with an adequate management-briefing procedure.

The code of conduct must also prevent relations with foreign exchange brokers from resulting in a situation where (part of) the dealers' activities can no longer be monitored. Thus, for example, no transaction may be accepted where the broker only provides the identity of the counterparty after an abnormally long delay.

3.4.3. Permanent critical supervision

Without prejudice to the necessary hierarchical supervision relating to the dealers' activities, all transactions must be subject to permanent, independent critical supervision.

This permanent supervision shall not relate to the desirability of the transactions, but, inter alia, to the checking of the accuracy and completeness of the data sent by the dealer to the administration department, the normality of the transactions concluded (rate, amount of the premium/discount on forward exchange transactions, size, etc) and their conformity with the general instructions and the internal specific rules drawn up by the management (e.g. observance of the internal limits imposed; distinguishing between trading and hedging transactions; distinguishing between linked and non-linked swaps; any internal transactions generated by the dealing room for technical reasons; transactions on behalf of staff, etc).

As indicated in section 3.4.1., this supervision should be effected without the dealer's involvement (or, more generally, that of the operational line). As a rule, they should be effected by the persons or department in charge of or responsible for the administrative processing of the transactions.

3.4.4. Administrative processing

The administrative processing of transactions shall be carried out, promptly and without the dealers' involvement, in a place which is separate from the dealing room (back office).

In a traditional organization, administrative processing should provide the following documents promptly, on the basis of dated and consecutively numbered returns completed by the dealers:

- the statements and tables relating to the risk positions for hierarchical monitoring purposes;
- the written confirmations which, after the addition of any signatures required, shall be sent immediately to the counterparty;
- the accounting documents;
- the payment orders.

The administration department shall at all times reconcile the statement of risk positions, as shown by the administrative and/or accounting statements and tables, with the risk positions as kept up to date by the dealing room (cf. 3.4.2.2.). Differences for which an immediate explanation cannot be found shall be notified promptly to the senior management responsible for activities on the money and foreign exchange markets.

As a result of increasing automation, the processing of dealing room transactions is becoming more and more integrated. Thus the dealer himself sometimes enters the transactions data in the data-processing system. The role of the back office (and consequently the principle of dual involvement) may not be dispensed with in such an automated system where transactions are not recorded on acceptance slips. The necessary measures must therefore be taken to ensure that the transactions are only confirmed, booked to account and executed after the back office has played its part.

Special instructions and procedures must be laid down for the processing of transactions which, towards the end of the day, are concluded by the dealing room at a time when processing work by the administration department has ceased. These special instructions shall ensure, in particular, that the information for the management at all times takes account of all the transactions effected.

The administrative processing department shall ensure the receipt, monitoring and checking of the incoming confirmations. An important element of supervision shall be the reconciliation of the conclusion date stated by the counterparty with the conclusion date stated by the dealer. If a confirmation is missing or raises certain questions, the administration department shall contact the counterparty immediately and in the event of a repeated absence of satisfactory explanations concerning an individual counterparty, the management responsible for the processing and supervision line - and, if necessary, the Banking Commission - shall be informed.

The administrative processing department shall, after the brokers' invoices have been checked, also draw up the account statements relating to the commission due to the intermediaries. Payment of this commission shall only be made after the appropriate member of the highest management body (or his deputy - cf section 3.4.6., sixth paragraph) has signed the account statements as being approved.

3.4.5. Accounting treatment

All transactions shall be entered individually in the accounts promptly every day.

An accounting plan must be drawn up for this purpose; it shall be the subject of a detailed, written and up-to-date specification.

The accounting system must in particular permit the establishment of inventories with the necessary revaluations and pro rata figures, and the constitution of the provisions needed for covering the risks incurred.

It must permit accurate and prudent measurement of the risk positions taken, of the profitability of the transactions (with inclusion in the results in accordance with the object of the transactions concluded), and of the size of the claims and commitments outstanding.

It must permit at all times the necessary reconciliations with the nostro accounts and with the position tables and statements which are provided outside the accounts. Any discrepancies discovered by the processing and supervision line shall be communicated without delay to the senior management responsible for activities on the money and foreign exchange markets.

In institutions where the accounts are made up towards the end of the day, before the dealing room closes, subsequent transactions shall be booked to account the following day before those for that day.

In institutions which have foreign branches, the information entered in the books shall include, every day, the data relating to these branches.

3.4.6. Monitoring by the appropriate member of the highest management body

The member of the highest management body referred to in section 2.2. shall monitor, in particular on the basis of the returns, tables and reports submitted to him for this purpose by the administration department, the risks associated with the activity concerned, observance of the limits set and the normality of the transactions, particularly as regards their pricing, their profitability, their maturity, their size per counterparty and per broker and the commission they generate.

In this connection, prompt, accurate and full reporting by both the operational line and the processing and supervision line (cf. section 3.4.1.) is of the utmost importance. The member concerned shall accordingly ensure that he is able at all times to have at his disposal the necessary adequate information (including that relating to the institution's foreign branches).

In particular, written statements of the risk positions taken, reconciled with the limits imposed, must be sent to him daily - or to his deputies (cf. the sixth paragraph of this section). In addition, the lists of transactions concluded stating, for each transaction, the date and time of its conclusion, the amount, the currency, the price, the maturity, the counterparty, the methods of payment, the name of the intermediary, the latter's charges and the amount of commission must be available daily.

The close-of-business data submitted must, certainly as regards the overnight position, take account of all the transactions executed, including those which have not yet been processed by the administration department.

The member shall be notified of the results of the transactions as calculated by the dealers and of their reconciliation with the administrative processing data and the accounting data.

Obviously, the circulation of the information referred to in the preceding paragraphs may be structured on the basis of a delegation of powers by the relevant member of the highest management body to the senior management responsible for activities on the money and foreign exchange markets. Nevertheless, the member in question must personally - even in the case of delegation - obtain systematically and on a daily basis at least summary tables and the necessary explanations concerning the principal underlying developments and transactions and must be able to ask for all the relevant detailed data.

He shall contact the management of an institution where he finds, on examining the volume of transactions for each counterparty, that it has expanded its activities to a substantial extent and without any obvious explanation, or appears to be operating abnormally.

The information that he provides to his fellow members of the highest management body concerning the exercise of his duties (cf. section 2.2.) shall be given in writing and at sufficiently frequent intervals. This information shall include in particular details regarding the volume of business, the observance of the internally imposed limits and the trend in the profitability of transactions.

3.4.7. Action taken by the internal audit department

As regards the institution's transactions on the money and foreign exchange markets, the internal audit department shall take action in accordance with its task of examining and assessing the proper functioning, effectiveness and efficiency of the internal supervision system (cf. the Banking Commission's circular of 6 April 1987).

At varying intervals it shall check in particular whether the hierarchical supervision and the independent, permanent critical supervision incorporated in the internal supervision system are functioning effectively, whether the transactions are being carried out correctly and have been notified and booked to account correctly and whether the instructions, procedures and codes of conduct (including the system of limits, the monitoring of observance of these limits, the administrative and accounting organization etc.) meet the requirements of prudent management.

The internal audit department shall at varying intervals send to the internal audit bodies of correspondents confirmation requests concerning all current transactions. It shall be responsible for monitoring the replies received. It shall deal in its turn with confirmation requests from correspondents. These specific confirmations may not be lumped together with the permanent written confirmation procedure covering all transactions that is carried out by the administrative services (cf. section 3.4.4.).

The internal audit department shall at varying intervals review the use of the telex system and other means of communication by which the transactions must be recorded. In this connection also, the continuous review shall, however, be the responsibility of the processing and supervision line.

It is evident that the frequency of the internal audit department's inspections relating to transactions on the money and foreign exchange markets must, in view of the size of the risks that may be incurred, be greater than that applying to most of the institution's other activities.

As is the case for the review of the institution's other activities, the internal audit department shall draw up written supervision reports copies of which shall be sent immediately to the external auditors.

3.5. Appointment of dealers: information for the Banking Commission; delegation of powers

In liaison with the Banking Commission, each institution shall determine the scope of the rule which stipulates that the Commission must be notified of appointments, resignations and dismissals of dealers who are authorized to conclude transactions for large amounts.

The relevant notifications must, in the case of resignations, state the reasons for the institution's decision. Notifications of appointments must be accompanied by a full curriculum vitae of the dealers concerned.

The dealers' powers (types of transaction, limits per transaction, etc.) shall, taking account of the limits described in section 3.3., be determined for each dealer or group of dealers by the highest management body or, in the case of delegation, by the senior management responsible for activities on the money and foreign exchange markets or by the head of the dealing room.
