

**Guidelines on exchange traded Interest Rate Futures –
Recommendations on operational controls
(paragraph 4.22)**

A. Segregation of Duties

There should be clear segregation, functionally and physically, between the front office and back office.

There should be a middle office independent of the trading room and it should be responsible, inter alia, for undertaking various risk related monitoring, product approval, validation of valuation models used, stress testing, back testing of the risk limits etc. and also for regulatory reporting and compliance.

B. Trade Entry and Transaction Documentation

Management should ensure that procedures are in place to provide a clear and fully documented audit trail of derivatives transactions.

All derivatives transactions should be sequentially controlled to ensure that all deals are accounted for and to provide an audit trail for deals effected.

Every transaction should be updated (i.e. mark to market) in the calculation of market and credit risk limits.

Deals should be transacted at market rates.

C. Confirmation Procedures

The method of confirmation used should provide a documentation trail that supports the institution's position in the event of disputes.

D. Settlement and Disbursement Procedures

Specific procedures should be established for the initiation of, and authority for, funds transfer.

Daily independent reconciliation of transferred funds with nostro accounts and general ledger is an essential control for detection of errors or misapplications of funds.

E. Reconciliation Procedures

All pertinent data, reports, and systems should be reconciled on a timely basis to ensure that the institutions official books agree with dealers' records. At the minimum, the following reports should be reconciled:

Unusual items and any items outstanding for an inordinately long period of time should be investigated.

There should be adequate audit trail to ensure that balances and accounts have been properly reconciled. Reconciliation records and documentation should be maintained and independently reviewed. Such record should be kept for an appropriate period of time prior to their destruction.

F. Revaluation Procedures

The revaluation procedures should cover the full range of derivatives instruments included in the institutions trading portfolio.

Revaluation rates should be obtained from or verified by a source (or different sources in the case of OTC derivatives) independent of the dealers, representative of the market levels and properly approved. Revaluation calculations should be independently checked.

Revaluation rates and calculations should be fully documented.

G. Exceptions Reports

To track errors, frauds and losses, the back office should generate management reports that reflect current status and trends for the following items:

- Outstanding general ledger reconciling items.
- Failed trades.
- Off-market trades.
- After-hours and off-premises trading.
- Aging of unconfirmed trades.
- Suspense items payable/receivable.
- Brokerage payments.
- Miscellaneous losses.
- Limit breaches
- Details of deals resulting in exceptional profits and losses

The management information system/reporting system of the institution should enable the detection of unusual patterns of activity (i.e. increase in volume, new trading counterparties, etc.) for review by management.