

## SECURITIES AND DERIVATIVES EXAMINATION PROCEDURES

### Expanded Analysis Decision Factors

*This section evaluates the significance of deficiencies or other specific concerns identified in the Core and Expanded Analyses. Click on the hyperlinks found within each of the Expanded Analysis Decision Factors to reference the applicable Expanded Analysis Procedures. If needed, proceed to the accompanying [Impact Analysis](#).*

**Do Expanded Analysis and Decision Factors indicate that risks are adequately identified, measured, monitored, and controlled?**

**E.1. Are the deficiencies immaterial to securities and derivatives activities management? Refer to Expanded Analysis [Procedures #1-21](#).**

**E.2. Are the deficiencies immaterial to the institution's overall condition? Refer to Expanded Analysis [Procedures #1-21](#).**

<b>SECURITIES AND DERIVATIVES EXAMINATION PROCEDURES</b>
<b>Expanded Analysis Procedures</b>

*Generally, procedures used in the Expanded Analysis should target concerns identified in the Core Analysis and Decision Factors. The flexible procedures specified for the Core Analysis also apply to the Expanded Analysis.*

<b>Policies, Procedures, and Risk Limits</b>
<p><b>1. Investigate why the policy deficiencies identified in the Core Analysis exist. Discuss recommendations with management. Possible reasons for policy deficiencies may include:</b></p> <ul style="list-style-type: none"> <li>• Management overlooked these issues,</li> <li>• Management is unfamiliar with prudent guidelines and procedures, or</li> <li>• Management is unwilling to create or enhance policies and procedures.</li> </ul>
<p><b>2. If compliance with policies or procedures is deficient, determine the reasons. Possible reasons include:</b></p> <ul style="list-style-type: none"> <li>• Poor internal communication of policy and procedures or subsequent revisions,</li> <li>• Lack of awareness of policy existence,</li> <li>• Disregard for established policies,</li> <li>• Misunderstanding of policy and procedures, and</li> <li>• Change in investment strategy.</li> </ul>
<p><b>3. Determine whether management commits to and supports proper controls and monitoring to ensure policy guidelines are followed in the future. Determine whether proposed controls, if any, are reasonable.</b></p>
<b>Internal Controls</b>
<p><b>4. Determine whether the operations staff is knowledgeable of existing policies, procedures, and controls.</b></p>
<p><b>5. When concerns with internal controls are identified in the core analysis, independently evaluate whether the internal control weaknesses expose the bank to material risks.</b></p>
<p><b>6. Determine whether purchase and sale prices are accurate by sampling trade tickets.</b></p>

<b>7. Confirm clearing account reconciliations.</b>
<b>8. Verify that confirmations are reconciled against trade tickets in a timely fashion.</b>
<b>9. Review a sample of general ledger tickets to test the accuracy of entries.</b>
<b>Audit or Independent Review</b>
<b>10. Assess any audit or independent review deficiencies identified in the Core Analysis.</b>
<b>11. Perform any Core Analysis procedures that were not adequately addressed during the audit or independent review.</b>
<b>Risk Identification, Measurement, and Reporting Systems</b>
<b>MARKET RISK</b>
<b>12. Assess management's methods for measuring and forecasting price sensitivity and market risk.</b> <ul style="list-style-type: none"> <li>• Determine whether the measurement methods are appropriate for the instrument's or portfolio's cash flow characteristics.</li> <li>• Determine whether management's assumptions on items such as interest rate shocks, prepayment forecasts, and current prices are reasonable and supported.</li> </ul>
<b>13. If necessary, request enhanced management analysis during the examination. Use management's improved analysis to assess market risk relative to the board's risk limits, earnings, and capital.</b>
<b>CREDIT RISK</b>
<b>14. Determine whether credit analysis demonstrates that the obligor has adequate capacity to meet the financial commitments of the security for the projected life of the asset or exposure. Adequate capacity is evident when the probability of default is low, and the full and timely repayment of principal and interest is expected.</b>

<p><b>15. Assess the overall credit risk from off-balance sheet derivatives and perform credit analysis of all counterparties with material positions. Management should maintain financial information (e.g., annual reports and SEC filings) on file.</b></p>
<p><b>LIQUIDITY RISK</b></p>
<p><b>16. Verify management's price information.</b></p> <ul style="list-style-type: none"> <li>• Obtain independent prices on a sample of the portfolio. If prices were obtained on a portfolio sample in the core analysis, expand the sample.</li> <li>• For instruments valued using the institution's or selling-dealer's model, ascertain whether management adequately supports the assumptions. If management cannot support the assumptions, or the assumptions appear unrealistic, request a revised valuation using more appropriate assumptions.</li> </ul>
<p><b>17. Assess management's intentions and the institution's ability to hold instruments with significant depreciation.</b></p>
<p><b>18. For material volumes of potentially illiquid instruments, verify that management's valuation methods consider liquidity risk under stress scenarios.</b></p>
<p><b>19. Determine whether the bank holds a significant volume of investments that it cannot sell at a price that reflects the instruments economic value due to limited market depth or unfavorable market conditions.</b></p>
<p><b>Board and Senior Management Oversight</b></p>
<p><b>COMPLIANCE</b></p>
<p><b>20. Determine the cause of any violations and identify the responsible party or parties. Consider the following items:</b></p> <ul style="list-style-type: none"> <li>• Lack of familiarity with laws or regulations,</li> <li>• Negligence,</li> <li>• Misinterpretation, and</li> <li>• Willful disregard or noncompliance.</li> </ul>

Expanded Analysis

**End of Expanded Analysis. If needed, Continue to [Impact Analysis](#).**

**SECURITIES AND DERIVATIVES EXAMINATION PROCEDURES**

**Impact Analysis Procedures**

*Impact Analysis reviews the impact that deficiencies identified in the Core and Expanded Analysis and Decision Factors have on the bank's overall condition, and directs the examiner to consider possible supervisory options.*

**Impact Analysis Procedures**

- 1. Assess the effect on the institution's safety and soundness of any supervisory concerns regarding management.**
- 2. Determine the effect that market, credit, liquidity, operational, and legal risks from securities and derivatives have on the institution's financial condition.**
- 3. Evaluate the effect that current and planned security and derivative activities may have on capital, asset quality, earnings, liquidity, and sensitivity to market risk.**
- 4. Gauge management's willingness and ability to correct deficiencies.**
- 5. Determine whether formal or informal administrative actions are warranted, formulate specific recommendations, and discuss concerns with the appropriate supervisors.**
- 6. Investigate potential recommendations for civil money penalties.**

**End of Impact Analysis.**