

SECURITIES AND DERIVATIVES

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](#).

E.1. Are deficiencies immaterial to management’s supervision of the securities and derivatives activities? Refer to Expanded Analysis [Procedures #1-19](#).

E.2. Are deficiencies immaterial to the institution’s condition? Refer to Expanded Analysis [Procedures #1-19](#).

SECURITIES AND DERIVATIVES EXAMINATION PROCEDURES

Expanded Analysis Procedures

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.

Policies, Procedures, and Risk Limits

1. Investigate the reason(s) policy deficiencies identified in the Core Analysis exist. Discuss recommendations with management. Possible reasons for policy deficiencies may include:

- Management overlooked these issues,
- Management is unfamiliar with prudent guidelines and procedures, or
- Management is unwilling to create or enhance policies and procedures.

2. If poor compliance with internal policies or procedures exists, determine the reasons. Possible reasons may include:

- Poor internal communication of policies and procedures or subsequent revisions to either,
- Lack of awareness of policies or procedures,
- Disregard for established policies or procedures,
- Misunderstanding of policies or procedures, and
- Change in the institution’s investment strategy.

3. Determine whether management recognizes and supports proper controls and monitoring consistent with the institution’s policy guidelines. Determine whether proposed controls, if any, are reasonable.

Internal Controls

4. Determine whether the institution’s operations staff is knowledgeable with respect to existing policies, procedures, and controls.

5. When concerns with internal controls are identified in the core analysis, independently evaluate whether those internal control weaknesses may expose the bank to material risks.

6. Review a sample of trade tickets to assess whether purchase and sale prices are accurate.

7. Confirm clearing account reconciliations.
8. Verify that confirmations are reconciled against trade tickets in a timely fashion.
9. Review a sample of general ledger tickets to assess the accuracy of entries.
Audit or Independent Review
10. Assess any concerns regarding audit or independent review functions identified in the Core Analysis.
Risk Identification, Measurement, and Reporting Systems
MARKET RISK
<p>11. Assess management’s methods for measuring and forecasting market risk in the securities and derivatives portfolio(s). Consider whether:</p> <ul style="list-style-type: none"> • The measurement methods are appropriate considering each instrument’s or portfolio’s cash flow characteristics. • Management’s assumptions concerning factors such as interest rate shocks, prepayment forecasts, and current prices are reasonable and supported.
12. If appropriate, request enhanced management analysis during the examination, and use this enhanced analysis to assess the institution’s market risk relative to earnings, capital, and board-established risk limits.
CREDIT RISK
13. Determine whether management’s credit analysis demonstrates that the obligor has adequate capacity to meet its financial commitments with respect to the security for the projected life of the asset or exposure. Adequate capacity is evident when the probability of default is low and full and timely repayment of principal and interest is expected.

<p>14. Assess credit risk from off-balance-sheet derivatives and perform credit analysis of all counterparties with whom management maintains material positions. Management typically maintains relevant financial information (e.g., annual reports, other SEC filings) on these counterparties.</p>
<p>LIQUIDITY RISK</p>
<p>15. Verify management’s price information.</p> <ul style="list-style-type: none"> • Obtain independent prices on a sample of the portfolio. If in the Core Analysis, prices were obtained, expand the sample as appropriate. • For instruments valued using a model, determine whether assumptions are supported appropriately by management. If management cannot provide support for the assumptions, or the assumptions appear unrealistic, request a revised valuation using appropriate assumptions.
<p>16. Assess management’s intentions and the institution’s ability to hold instruments with significant depreciation.</p>
<p>17. To the extent the portfolio(s) includes material volumes of potentially illiquid instruments, verify that management’s valuation methods appropriately consider liquidity risk under stressed scenarios.</p>
<p>18. Determine whether the portfolio(s) includes a significant volume of investments that potentially could not be sold at a price reflecting their expected economic value due to limited market depth or other unfavorable market conditions.</p>
<p>Board and Senior Management Oversight</p>
<p>COMPLIANCE</p>
<p>19. Identify the cause(s) of any compliance violations and identify the responsible party or parties. Consider the following factors:</p> <ul style="list-style-type: none"> • Lack of familiarity with laws or regulations, • Negligence, • Misinterpretation of laws or regulations, and • Willful disregard.

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