

Task Force Objectives, Structure and Intent

Introduction

In February 1995 Barings PLC, an international financial institution with a 200-year history, collapsed as a result of substantial trading losses incurred by a Barings employee. These losses were caused in large part by a lack of adequate internal controls over the employee's proprietary trading activities, including those conducted in exchange-traded futures and options. The Barings failure did not result in losses to other market participants and, in many respects, the situation underscored the fundamental strength and soundness of the global futures and options regulatory, trading and clearing systems. Nevertheless, the events surrounding the Barings failure prompted market participants to consider certain national and cross-border issues related to the structure and operation of the international markets for exchange-traded and/or cleared futures and options. The most significant of these issues included mechanisms that exist for the protection of participants' assets, the internal controls and risk management procedures employed by exchanges/clearinghouses, brokers/intermediaries and customers, and the communication of information regarding the activities of market participants by exchanges/clearinghouses and regulatory authorities.

The Futures Industry Association Global Task Force on Financial Integrity was organized in March 1995 to address these issues. The Task Force includes representatives of major international exchanges/clearinghouses, brokers/intermediaries (including futures commission merchants and other brokers), and customers from 17 jurisdictions.

Task Force Objectives

The Task Force strongly believes that the global futures and options markets offer significant advantages and protections, such as transparency, liquidity and the elimination of direct credit exposure to trading counterparties, many of which are not present in other markets. These features, among others, promote confidence in the markets and provide an efficient environment in which to transact business. The primary goal of the Task Force is to enhance the protection of the assets of market participants and, as a means of achieving this objective, to:

- provide information and education about the global futures and options markets;
- provide market participants with a means of evaluating and comparing exchanges/clearinghouses and brokers/intermediaries;
- improve cross-border coordination and communication among exchanges/clearinghouses and regulators in the same and different jurisdictions, as well as the level of information available regarding the activities of market participants;
- promote, where necessary, changes in existing laws or regulations to facilitate the realization of the objectives;
- improve internal risk management by brokers/intermediaries of exposure to customer positions;
- improve internal risk management by brokers/intermediaries and customers of their own trading activities, including the activities of affiliates (proprietary trading); and
- enhance public confidence in the global exchange-traded futures and options markets.

The objectives of the Task Force are similar to those of the international regulatory authorities that issued the "Windsor Declaration" in May 1995.

Task Force Structure

The Task Force has focused its examination on the global markets for futures and options executed on and/or cleared by organized exchanges/clearinghouses. The organization of the Task Force and its recommendations reflect the fundamental structure of the global futures and options markets. These markets are typically structured around a centralized exchange and/or clearinghouse, which is responsible for the clearance and settlement of such transactions and the financial obligations of the participants. On most markets, the exchange/clearinghouse maintains a direct legal relationship only with its members, not with the ultimate customers. The rules, oversight and market protection mechanisms of the exchange/clearinghouse generally extend only to its members, and any benefits or obligations regarding customers arise indirectly as a result of the relationships between the customers and their clearing members.

The Task Force is divided into three committees-exchanges/clearinghouses, brokers/intermediaries and customers. Each committee prepared a separate survey that was disseminated to a large number of market participants. These surveys generated responses from all sectors of the global futures and options industry and provided the Task Force with extensive information on the structure and operations of markets and their participants. The Task Force used the responses to develop its recommendations during a series of meetings, including sessions held in Washington, D.C. in May 1995 and in London in June 1995.

The recommendations are based on the principle that exchanges/clearinghouses, brokers/intermediaries and customers each have responsibilities with respect to their own activities and the operation of the system as a whole and that the markets function effectively only when market participants at all levels fulfill these responsibilities. For this reason, the three areas addressed below are interrelated and should be considered as a single integrated set of recommendations. The Task Force believes that the implementation of these recommendations will significantly advance the objectives of the Task Force.

Task Force Intent

The Task Force recommendations are intended to provide general guidance to market participants regarding issues and principles which the Task Force believes should be taken into consideration by such participants in structuring their activities. The Task Force does not intend the recommendations to be construed as definitive requirements that must be met by regulatory systems, markets or market participants, or to identify deficiencies in any particular regulatory systems, markets or institutions. Each exchange, clearinghouse, broker/intermediary and customer must develop its own policies and procedures that are appropriate in the context of its particular laws, practices and circumstances.

The Task Force recognizes that no one approach can be appropriate for all markets or participants. In fact, some recommendations may be unnecessary or even inappropriate for brokers/intermediaries and customers whose activities in the futures and options markets are limited; market participants should evaluate the costs and benefits of these recommendations in light of their exposure to the markets relative to their overall businesses. The Task Force also recognizes that it may be appropriate for exchanges/clearinghouses, brokers/intermediaries or customers to rely, at least in part, on the strength of the regulatory and oversight system governing a market and the activities of market participants. In certain instances, the existence of such a regulatory and oversight system may address a number of the issues raised by the recommendations.

In addition, while there will continue to be important and fundamental differences among the laws and practices of various jurisdictions, the Task Force expects there to be improved coordination structured around the financial integrity objectives reflected in its recommendations. Further, where existing laws or regulations prevent or inhibit the implementation of appropriate recommendations, the Task Force urges legislators or regulators to change such laws or regulations.