Recommendations For Customers

Legal Relationships with Brokers/Intermediaries

Customers should implement and enforce policies and procedures that are appropriate in the context of their businesses and the nature and level of their trading activities, (1) regarding the establishment of relationships with brokers/intermediaries, including specific criteria for the selection of brokers/intermediaries and the designation of personnel with the authority to negotiate, approve and execute agreements with brokers/intermediaries, and (2) ensuring that personnel with responsibility for reviewing and approving agreements, and monitoring relationships with brokers/intermediaries, are independent of the customer's trading personnel.

Customers should ensure that they understand the risks of their trading activities, the nature of their legal relationships with their brokers/ intermediaries and the risks of utilizing their brokers/intermediaries and of trading on specific exchanges/clearinghouses (including an understanding of applicable laws and regulations of relevant jurisdictions). Customers should also ensure that they understand the nature of each broker/intermediary's legal relationships with relevant exchanges/clearinghouses, clearing brokers and depositories, and the risks to the customer arising from such relationships.

Customers should consider whether the following issues are addressed in each written agreement with a broker/intermediary and should, in establishing credit and/or position limits with each such broker/intermediary, take into account the manner in which such issues are dealt with in such agreement: (1) the broker/intermediary's right to close out the customer's account and liquidate positions, and the notice periods required for such actions; (2) the broker/intermediary's right to collect margin in excess of exchange/clearinghouse requirements; (3)the customer's right to withdraw excess margin; (4) the management of customer property held by the broker/intermediary; (5) the customer's exposure to the failure of exchanges/clearinghouses; (6) the customer's exposure to the failure of clearing brokers selected by the broker/intermediary; and (7) the customer's exposure to the failure of depositories holding customer property.

Risk Assessment of Brokers/Intermediaries

Customers should consider, based on the terms of their agreements with their brokers/intermediaries and the allocation of responsibilities in such agreements, the credit and other material risks arising from the execution and/or clearing of transactions through such brokers/intermediaries.

The primary factors to be considered with respect to each broker/intermediary should include, among others, its credit standing, capital and financial condition, the exchanges/clearinghouses of which the broker/intermediary is a member, the type of firm (for example, a bank, securities broker, insurance company or an affiliate thereof), and whether or not it engages in trading for its own account and/or carries accounts for its affiliates. Other factors that might also be considered, depending on the size and nature of the customer's trading activities and the extent of the customer's use of the broker/intermediary, include the broker/intermediary's management experience and capabilities, operational capacity, risk management systems and disaster recovery procedures.

As part of its evaluation of its brokers/intermediaries, a customer should be aware of and consider the risk arising from the potential default of the broker/intermediary as a result of (a) the trading activities of the broker/intermediary or its affiliates, (b) the trading activities of other customers of the broker/intermediary (and customers should, in this connection, consider the procedures used by the broker/intermediary in establishing customer accounts and in the monitoring and management of credit and other risks arising from its carrying of such accounts), and (c) the default of a clearing broker or depository utilized by the broker/intermediary.

Based on its consideration of the credit risk arising from the execution and/or clearing of transactions through a particular broker/intermediary, a customer may wish to consider obtaining from the broker/intermediary a form of credit enhancement, such as an affiliate guarantee or the guarantee (or letter of credit) of a third party. If a customer relies on such forms of credit enhancement, it should ensure that the terms and scope of such credit enhancement are understood by and acceptable to the customer and that the credit enhancement is legally enforceable.

Risk Assessment of Exchanges/Clearinghouses

Customers should consider information available about the risks of trading on particular exchanges/clearinghouses, prior to executing trades on such markets. Such risks should also be considered on an ongoing basis.

Among the factors that might be appropriate to consider in determining whether to transact on a particular exchange/clearinghouse are the quality of the regulatory and oversight system of the exchange/clearinghouse, the applicable financial integrity system, relevant customer protection mechanisms (e.g., segregation requirements, account insurance, guarantees or compensation funds), the extent to which the exchange/clearinghouse has the right to force the liquidation of customer positions, the source and liquidity of relevant financial support, the margining and settlement system (including the variation margin settlement periods and the extent to which variation margin is paid out to customers), the ability to transfer positions and property in the event of a default, other operational issues and the applicable legal and regulatory system, including applicable bankruptcy laws.

Internal Risk Management Procedures

The Board of Directors or senior management of a customer should, in the manner and to the extent appropriate in the context of its business and the nature and level of its trading activities, understand its proposed trading activities and establish general risk management guidelines and procedures for such activities, including instruments and strategies, position and trading limits for trading desks, business units and/or individual traders, receipt of confirmations and other appropriate documents, periodic stress testing and cash flow analysis and determination of "value at risk". Compliance with such procedures and limits should be monitored on a regular (and, where appropriate, daily) basis by personnel independent of trading personnel. The Board of Directors or senior management should periodically review and modify such guidelines and policies, as necessary or appropriate.

A customer should, in the manner and to the extent appropriate in the context of its business and the nature and level of its trading activities (1) establish and enforce policies and procedures to review, on a regular basis, market, credit, operational and other risks arising from its trading activities, including daily reconciliation of trades, margin requirements and open positions and monitoring of hedging or arbitrage positions, (2) ensure that such functions are performed by personnel independent of trading personnel, and (3) ensure that internal reviews of compliance with such policies and procedures should also generally be conducted by personnel independent of trading personnel.

Adequate separations should be imposed between (a) back office personnel responsible for trade reconciliation, margin, preparation and maintenance of books and records and other similar matters, as well as compliance personnel, risk management personnel and treasury or funding personnel, and (b) personnel responsible for the customer's trading activities. The authority of appropriate personnel in these areas should be clearly established.

Customers should establish appropriate credit and/or position limits for each broker/intermediary, based on their credit assessment of the broker/intermediary. Credit exposure to each broker/intermediary should, where warranted and feasible in light of the size and nature of the customer's business and the level of its trading activities, be monitored regularly by personnel independent of trading personnel. Customers should establish procedures for managing excess margin held by brokers/intermediaries.

Those customers with substantial exposure to brokers/intermediaries as a result of the customers' trading activities should establish and maintain back-up clearing relationships with brokers/intermediaries to be utilized in emergency situations. Such relationships should include completed contractual arrangements with such back-up brokers/intermediaries and periodic testing of procedures for transfers of positions and property and continuation of trading.

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