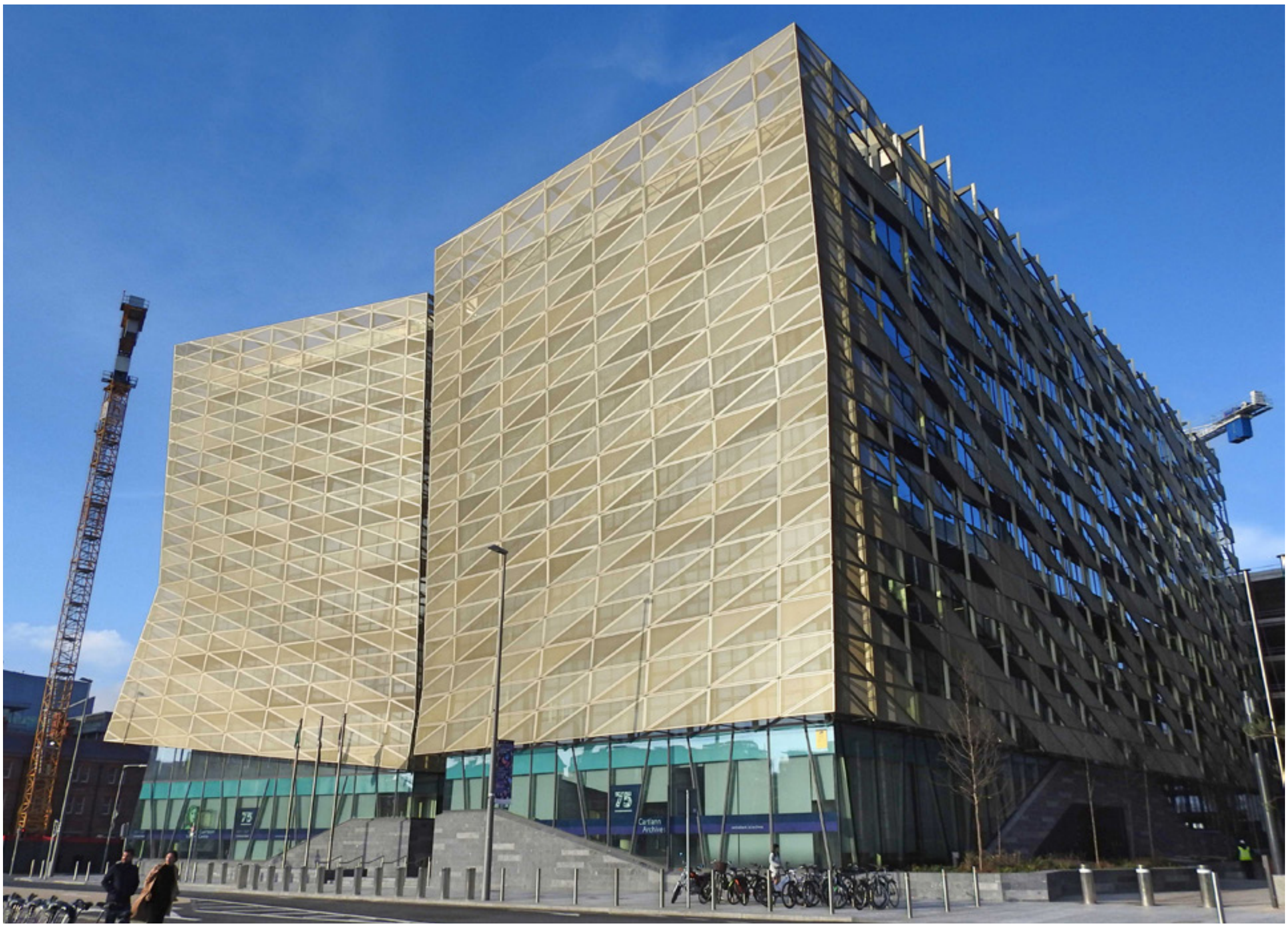
A long list of expectations for those impacted by the Central Bank of Ireland's Securities Markets Risk Outlook Report

On 8 February 2021, the Central Bank of Ireland ("**Central Bank**") published its first Securities Markets Risk Outlook Report (the "**Report**"). The Report details key conduct risks to securities markets and sets out actions which Regulated Financial Service Providers ("**Firms**"), investors and market participants should take to identify, mitigate and manage those risks. The Report builds on the Dear CEO Letter issued to Firms in 21 January 2020 ("**Dear CEO Letter**") on wholesale market conduct risk. For a full review of the Dear CEO Letter, please see Matheson's Insight here. The Report also outlines the Central Bank's supervisory priorities for securities markets in 2021.

Colm Kincaid, Director of Securities and Markets Supervision, on the launch of the Report, stated that the Central Bank expects firms "*to take concrete steps in 2021*" towards meeting the Central Bank's expectations detailed in the Report. He further stressed that Firms "*can expect us to challenge them on these expectations throughout 2021 and beyond, underpinned by the detailed rulebook that is in place and the range of powers available to us to enforce that rulebook.*" This is a very clear message to impacted Firms and a definitive call to action.

In respect of each of the eight key areas of conduct risk identified, the Central Bank sets out the context in which the particular risks arise and then goes on to detail the Central Bank's expectations in respect of the specific steps which Firms should be taking to mitigate these risks. While the drivers behind why the risks have been identified is important, the most crucial piece is what impacted Firms need to do in respect of said risks. With this mind, to aid impacted Firms in navigating the Central Bank's expectations, we have summarised below the steps identified in the Report.



1. **Successfully managing the migration to greener securities markets**
   - Review sustainable product offerings to ensure they meet the required standards and that the features and risks of those products are properly explained. This includes highlighting any risks or caveats to their sustainable features.
   - Consider preparedness for the transition to greener securities markets, the conduct risks arising within the Firm from this transition and how to identify, mitigate and manage those conduct risks.

2. **Managing the increasing complexity in securities markets and the rules that govern them**
   - Ensure products the Firm produces are designed to meet investors' needs, that conflicts of interest are mitigated and that key features and remaining conflicts of interest are addressed clearly and prominently in product disclosures. The Firm's consideration of these issues should be documented and available to the Central Bank on request.
   - Engage with the Central Bank before submitting applications for authorisation of more innovative investment funds and issues of securities where prospectus approval is required.
   - Identify and understand the risks associated with greater complexity and fragmentation and the implications this complexity might have for how markets perform in case of shocks.
   - Be vigilant to the potential for new products and changes in trading activity to give rise to unanticipated changes in market dynamics.
   - Be cognisant of all risks that may arise from the transition away from IBORs based on Firms business activity and to have a plan to mitigate those risks, including appropriate communication and disclosure to clients.

3. **Ensuring meaningful transparency for investors and other market participants, in particular on costs and fees**
   - Deliver financial products that serve the real needs of investors, other market participants, issuers and the wider economy and explain those products in a clear, straightforward manner.
   - Disclose all costs and fees in a manner that is clear, meaningful and easily accessible.
   - Describe the product or service being provided in return for those costs and fees in sufficient detail for their value to be properly assessed.
   - Disclose prominently the risks associated with an investment product or service.

4. Understanding the risks and implications of the increased use of indices, as well as being transparent with the market on their use

- Ensure the Firm understands fully the nature and implications of any indices they are using to inform or drive their market activity.
- Make sure the Firm has considered fully the extent to which their use of indices is transparent to investors and other market participants.
- Assess the Firm's relationship with index providers to ensure investors' best interests are being considered. This includes considering conflicts of interest.

5. Bolstering systems to identify, mitigate and manage misconduct risk, with a particular focus on the risk of market abuse

- In the case of issuers, have specific measures in place to ensure timely disclosure of inside information to the market. This includes information related to COVID-19, Brexit and other relevant developments.
- Ensure the Firm has clear policies on how inside information is controlled and handled and that these policies are followed in practice.
- In the case of financial service providers, continue to ensure that their surveillance systems remain robust and effective in the detection of abusive behaviours, including where markets are volatile or trading volumes are exceptionally high, and that cases of concern are dealt with appropriately.
- In the case of financial service providers, review their trade surveillance systems on a regular basis to ensure thresholds and parameters for alerts remain appropriate as market practices develop and in light of developments such as the prolonged working from home environment.

6. Ensuring governance arrangements are fit for purpose and properly resourced, including as businesses expand or change

- Ensure the Firm has sufficient resources, systems and controls in place to identify, mitigate and manage the conduct risks to which they are exposed, with clear governance and board oversight.
- Review outsourcing/delegation arrangements on a regular basis to ensure that the Irish regulated entity has sufficient control over the conduct of outsourcees. This includes having sufficient resources and expertise to effectively oversee the activity outsourced and ensuring resilience in times of market or operational stress.
- Ensure conflicts of interest are identified and avoided where possible. Where they cannot be avoided, firms should mitigate and manage the remaining risk appropriately.

- Where group resources, policies or processes are used to manage conduct risk, ensure sufficient local management autonomy and oversight of these resources, policies and processes. In particular, firms need to ensure that their boards and other management structures are not bypassed by group arrangements.
- Take a diligent approach to meeting the Firm's obligations under the Fitness and Probity Regime including as it applies to controlled functions that are not pre-approval controlled functions.

7. Improving the quality of the data Firms use in their business and report to the Central Bank

- Devote sufficient resource and senior management focus to ensuring data is timely and accurate, both to support risk management and decision making within the firm and to meet regulatory reporting obligations.
- Regularly and actively, discuss data quality at board level and relevant risk management fora.

8. Dealing with the impact of external shocks

COVID-19

- Have appropriate resources, expertise and systems in place to identify, mitigate and manage conduct risks accompanied by well-defined escalation processes. This includes conduct risks arising within outsourcees.
- Communicate transparently with investors and the wider market. This applies to issuers of financial instruments as well as regulated financial service providers.
- In the case of investment funds, monitor and manage liquidity risk effectively, including stress tests based on worst-case scenarios. Firms also need to have clear playbooks in place and deal transparently with investors with regard to both the risks involved and how they are managing them.

Brexit

- Ensure the Firm has identified all Brexit risks to which they are exposed and have contingency plans in place, including dealing with all plausible worst case scenarios. These plans need to look at conduct risks arising over the immediate, medium and longer-term time horizons.
- Assess whether any business or portfolio realignment needs to take place to ensure continued compliance with EU regulations.

- Ensure that the conduct risks and obligations of Irish regulated entities are owned and controlled by the Board of the Irish entity, with clear escalation paths for issues as they arise.
- Communicate clearly and transparently with investors, counterparties and the market (where appropriate) on any potential effects stemming from Brexit.
- Have measures in place to deal effectively with market dislocations and fragmentation that may arise from Brexit.

Commentary:

It is interesting to note that the Central Bank placed "*dealing with external shocks*" as the first in its list of conduct risks, identifying COVID-19 and Brexit as specific eternal shocks. We have included this risk but moved it to the end. In our experience, clients have dealt very successfully with Covid-19 and for almost all clients, Brexit is disappearing into the rear view mirror. So while these two areas were clearly amongst the most important risks in 2020, we don't think they will be for 2021 and beyond, and that the other risks listed are more relevant for the future.

Next Steps:

In the Report the Central Bank also explains that it has planned a number of work items for 2021 that relate specifically to the Report, as well as ongoing matters. These include:

- an industry-wide review of compliance with the Market Abuse Regulation;
- further work arising from findings in its 2020 thematic reviews in the funds sector:
- continuing its work with ESMA and fellow EU regulators to progress Common Supervisory Actions in relation to UCITS (in the field of liquidity risk management and in costs and fees); and
- the ongoing trigger-based supervision of conduct risk in securities markets.

It is clear from the foregoing that the Central Bank deems that there is a significant amount of work to be done by Firms to meet its expectations and they are pursuing various avenues to ensure these expectations are met.

We would strongly recommend that Firms carry out a gap analysis of their current conduct risk framework as against the key conduct risks stipulated in the Report and the express expectations of the Central Bank on how to address these risks. Following this, Firms should then look to update their conduct risk framework and related process and procedures in response to any identified shortcomings. One of the phrases which arises again and again in the Report is "*identify, mitigate and manage*" the risk. This is a very good yardstick to apply in meeting the Central Bank's expectations.

While not expressly identified, we would also recommend that Firms update their boards in respect of the contents of the Report and the Firm's plan to assess its compliance with the Central Bank's expectations.

Matheson are happy to assist with any queries you may have and offer a broad range of services from a full review and gap analysis of conduct risk frameworks, to specific technical advice on net issues.

Please see below details of our team who have expertise in this area.

Contacts

Joe Beashel
Partner
T +353 1 232 2101
E joe.beashel@matheson.com

Louise Dobbyn
Partner
T +353 1 232 2094
E louise.dobbyn@matheson.com

Claire Scannell
Professional Support Lawyer
T +353 1 232 2287
E claire.scannell@matheson.com