WHOLESALE MARKET CONDUCT RISK OVERVIEW

INTRODUCTION

On 21 January 2020, Derville Rowland, Director General of Financial Conduct at the Central Bank of Ireland (the "Central Bank") issued a Dear CEO industry communication in respect of wholesale market conduct risk thematic review by a specialised team, the Wholesale Market Conduct Team. The Central Bank established the Wholesale Market Conduct Team in order to carry out market conduct risk assessments of firms engaging or applying to engage in wholesale market activity.

The Dear CEO letter sets out the Central Bank's findings (good and bad practices) in respect of its engagement with 24 regulated entities, including on-site inspections of 10 regulated entities and branches of Irish entities in other jurisdictions. Central Bank supervisors conducted over 150 interviews of directors and CEOs, risk and compliance officers and frontline staff and the Central Bank continues to engage with relevant entities in relation to identified deficiencies.

The letter describes the key findings as set out below, noting that the central theme from the review was that firms did not adequately identify the market conduct risk that they were exposed to and as such could not appropriately mitigate and manage risk.

1. Inadequate market conduct risk frameworks

Bad Practices	Good Practices
Failure to identify market conduct risk: this was mainly down to regulated entities having a framework that was not appropriate for their specific circumstances, or were too high level and therefore the entities were missing the relevant market risks.	Engaging proactively with industry communication to establish an effective market conduct risk framework.
Inadequate market conduct risk Management Information ("MI"): the Central Bank concluded there was a general lack of understanding from a staff level of MI. There was an inadequate reporting structure set up in many of the regulated entities.	Regulated entities who engaged in regulatory horizon scanning exercises to develop a bespoke framework that staff were aware of and understood fully were noted by the Central Bank as "doing well".
Lack of staff understanding of market conduct risk: which reflects a failure of firms to embed their market conduct risk frameworks effectively.	
Lack of proactive identification of conflicts: The regulated entities that were aware of risks appeared to be event driven or reactive only.	

Central Bank Expectations

- Local and branch level risks should be considered alongside the centralised group risk management functions.
- Entities should have a conduct risk identification process.
- Market conduct-related MI, that is fully understood and reviewed by the staff should be used.
- Potential conflicts of interest should be considered in the risk identification process.

2. Inadequate governance of market conduct risk

Bad Practices	Good Practices
Poor governance of market conduct risk: poor understanding of risk and market impact of risk at a senior management level. Lack of regular challenge by boards.	A successful market conduct risk function was mature, embedded, and exhibited ownership or risk that could be challenged.
Poor governance in the global context: the Central Bank observed poor information flow and poor market conduct risk related decision making autonomy at CEO level of some Irish regulated entities of global firms.	Appropriate fitness and probity compliance was conducted by managers who had engaged with the 8 April 2019 dear CEO letter.
Poor governance in the context of the fitness and probity regime: the Central Bank identified some Pre-Approved Controlled Function ("PCF") holders focusing solely on profit generating activity, not discharging their full responsibility to have oversight and control over all activities.	

Central Bank Expectations

- Market conduct research should be in group arrangements that facilitates challenges of group decisions and approaches.
- Periodic assessment should be conducted.
- Successful information flow includes a mechanism to facilitate reporting to the Central Bank.
- Fitness and probity reviews of all staff, particularly PCF holders, should be carried out.

3. Failure to identify the risk of market abuse

Bad Practices	Good Practices
Inadequate trade surveillance: this was observed for MAR and other risk including surveillance, changes in traders and execution patterns.	STOR submissions to the Central Bank were generally good.
Inconsistent approaches to Suspicious Transactions and Order Report (“**STOR**”) submission: there was inconsistency with the identification of an order or transaction that would constitute market abuse.	
Poor quality communications between regulated entities and issuer investor relations functions: insider information concerns were not being considered in communications between regulated entities and issuer investor relations functions.	

Central Bank Expectations

- Trade surveillance systems should be reviewed on a periodic basis considering the nature and frequency of the data, the extent of the review and the analysis of data.
- Responsibility of compliance still rests with the regulated entity even if this task is outsourced.
- Staff need to have clear communication and responsibility lines for both trade surveillance and internal escalation of alerts.
- Quality and quantity of STOR submissions must be considered on a case by case basis.
- Unlawful disclosure and insider dealings should be considered during all communications.

Identification of risk

The key finding of the Central Bank was that firms failed to identify what market conduct risks are inherent to their specific business. As a consequence firms did not have an adequate conduct risk framework in place. The rationale behind the Central Bank not providing a definition of "risk" was to facilitate firms to look specifically at their own individual circumstances to define the risk facing them. The January Dear CEO letter has shown that having a generalised policy is not sufficient.

Accountability at a granular level

It is notable that the Central Bank carried out a broad range of interviews across front, middle and back office and did not solely focus on interviewing controlled functions. By doing so, it is clear the Central Bank expects all staff in firms to live and breathe its conduct risk framework. It is not sufficient to have a framework in place that is not properly embedded into the business of the firm. Each individual staff member must fully understand and implement the framework.

The conduct risk framework should therefore form part of day to day business of a firm.

Market abuse and reporting

The January Dear CEO letter reveals that many firms did not have a consistent definition and understanding of market abuse that filtered down from the board, to management, to individual staff. If a firm is not reporting suspicious behaviour, then there is a clear gap in their market conduct risk framework and implementation. Knowledge of reporting lines, whistle blower policies, and engaging in reporting is also crucial.

Types of firms

The Central Bank conduct risk inspection is wide in its remit. The focus on market abuse has important points for regulated firms, issuers and persons who act on behalf of issuers (whether they are regulated or not). Wholesale market activity captures a wide host of regulation including MiFID II, MAR, Central Bank reform Act, Investment Firm Regulations 2017, EMIR, CSDR and SFTR.

Next Steps

- Bring this letter to the attention of the board.
- Analyse your own conduct risk framework and implementation and consider revising it or initiating further training, particularly in light of Central Bank findings (good practices, bad practices and 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.