

### Central Bank identifies deficiencies in investment firms' management of conduct risk

On 21 January 2020, the Central Bank issued an industry letter identifying areas in which firms operating in the wholesale market have failed to meet its expectations for managing conduct risk.

#### Central Bank's expectations for managing conduct risk in the wholesale market

Regulated firms are already subject to an extensive set of rules governing their conduct, including under the MiFID and Market Abuse regimes and the Central Bank's Fitness & Probity regime. To be successful in meeting these obligations, however, the Central Bank states that:

*"compliance efforts must be underpinned by an equally systematic approach to ensuring that a culture prevails within firms that supports the objectives financial services regulations seek to achieve. This means fostering an approach that seeks the outcomes being worked towards not just because that is what the rules say, or the fear of being caught, but because it is the right approach based on acceptable outcomes and customer interests. It also means taking a careful look at how decisions affecting users of financial services are actually made within your firms and who is making them."*

The following is an analysis of the Central Bank's expectations, and the good/poor industry practices it has identified, in respect of the identification, management and mitigation of wholesale market conduct risk (**MC risk**).

Regulatory Expectations	Good Practices Identified by Central Bank	Poor Practices Identified by Central Bank
<p>Adopt Market Conduct Strategy to:</p> <ul style="list-style-type: none"> <li>identify MC Risks applicable to the business model of the firm at a local and branch level;</li> <li>embed management of identified MC Risks in the strategy of the firm;</li> <li>consider identified MC Risks in strategic planning (e.g. annual planning and budgetary processes);</li> <li>formally assess identified MC Risks and target outcomes;</li> <li>communicate identified MC Risks across business lines;</li> </ul>	<p>Proactive establishment of comprehensive and effective MC Risk framework.</p> <p>Undertaking regulatory horizon scanning exercise taking account of MC Risk specific to the firm.</p> <p>Designing bespoke MC Risk framework with embedded controls to mitigate risk and routinely test control effectiveness</p>	<p>Absence of structured, firm-specific or proactive MC Risk identification process.</p> <p>MC Risk framework not fit for purpose and/or did not identify controls to mitigate MC Risks identified.</p> <p>Inadequate communication with staff and testing of controls in place.</p>

Regulatory Expectations	Good Practices Identified by Central Bank	Poor Practices Identified by Central Bank
<ul style="list-style-type: none"> <li>consider extent of reliance on firm's group, as well as extent of input from firm, in embedding identified MC Risks into risk management process;</li> <li>if the firm books risk to its balance sheet, demonstrate how it manages and mitigates identified MC Risks including ability to reject group/intra-group business.</li> </ul>	<p>Demonstrating staff understanding and awareness of nature and impact of MC Risk particular to the firm.</p>	<p>Lack of basic understanding of what constitutes MC Risk.</p>
<p>Governance &amp; Organisation structure to address MC Risk:</p> <ul style="list-style-type: none"> <li>objectives of senior management to include management and mitigation of MC Risks;</li> <li>if part of a group, firm's group level decision-makers must have knowledge, expertise and capability to make decisions for local entity;</li> <li>clarify Board and executive committee responsibilities and accountabilities for managing and mitigating MC Risks;</li> <li>articulate MC Risk in roles and responsibilities for business, control and audit functions of firm;</li> <li>periodically assess capacity for managing MC Risks;</li> <li>consider MC Risks in process of establishing reporting lines, escalation paths and outsourcing arrangements;</li> <li>if part of group, firm to ensure effective oversight of non-Irish branch activities/affiliates;</li> <li>ensure sufficient levels of control to monitor, marshal, receive and, if appropriate notify the Central Bank of MC Risk issues whether or not conduct takes place in Ireland.</li> </ul>	<p>Demonstrable ownership of MC Risk by management</p> <p>Demonstrable engagement and constructive challenge at management level on MC Risk</p> <p>High levels of awareness of F&amp;P regime by managers of non-Irish EEA branches (PCF-16) by those who engaged with Central Bank's F&amp;P Dear CEO letters in 2019</p>	<p>Lack of understanding/ challenge/over-sight of MC Risk framework and impact of MC Risk at senior management level</p> <p>No CEO autonomy of MC Risk decision-making</p> <p>Senior staff in Ireland effectively reporting on a hard-line basis to group management for market conduct purposes</p> <p>Poor flow of conduct-related information between Irish entity and its branches / affiliates</p> <p>PCFs not discharging responsibilities with a particular concern in respect of PCF-29 (Head of Trading)</p>
<p>Firms' risk management process should:</p> <ul style="list-style-type: none"> <li>classify, e.g. using taxonomy/inventory, MC Risks;</li> <li>formally schedule MC Risk identification process;</li> <li>role of front office / client facing staff in MC Risk identification process;</li> <li>determine actions as a result of MC Risk identification;</li> </ul>	<p>Content of STOR submissions to the Central Bank is generally good</p>	<p>Ineffective Market Abuse Regulation (MAR) trade surveillance.</p> <p>Insufficient monitoring of, challenge to and supervision of outsourced trade surveillance activity</p>

Regulatory Expectations	Good Practices Identified by Central Bank	Poor Practices Identified by Central Bank
<ul style="list-style-type: none"> <li>formally document control environment and map controls to MC Risks identified;</li> <li>periodically assess trade surveillance systems (note, this was specifically raised in response to the poor practices identified as set out in the column to the right).</li> </ul>		<p>Inconsistent decision-making processes in respect of activities that should generate Suspicious Transaction and Order Reports (STORs)</p> <p>Failure to consider extent to which information might be inside information when communicating with issuer investor relation functions</p>
<p>Establish a culture which builds on shared purpose and standards such as professionalism, honesty, integrity and accountability through:</p> <ul style="list-style-type: none"> <li>people management, including use of financial and non-financial performance measurements, conduct of business, treatment of MC Risk throughout employee life cycle;</li> <li>consistent reinforcement from top down, via established communication strategy, the ethics, values and behaviours expected of staff and identified MC Risks;</li> <li>training and development programmes for staff education of behaviour and management of MC Risks which include performance implications for non-completion and input and evaluation from senior executive;</li> <li>compliance with F&amp;P regime.</li> </ul>	[None identified]	[None identified]
<p>Establish metrics and monitoring for management information including in respect of escalation triggers, follow-up actions and changes to policies, procedures and controls.</p>	[None identified]	[None identified]

## Next Steps

As part of its 2020 supervisory work programme, the Central Bank has noted that it will be “focussing on regulated entities’ ability to identify market conduct risk; the extent to which they are sufficiently well controlled to govern wholesale market conduct risk; and the flow and escalation of conduct-specific information within and across regulated entities and groups”

## How Can William Fry Help?

William Fry can assist firms with:

- carrying out an assessment of current conduct risk framework and practices as against the published expectations of the Central Bank;
- the development of tailored employee and staff training programmes in relation to the conduct risks of market transactions and risk management;
- advice on the rules, framework and domestic/international best practices and processes in the area of wholesale market conduct; and
- regulatory enforcement action.

## Contact Our Financial Regulation Unit

For further information, please contact any member of the William Fry Financial Regulation Unit or your usual William Fry contact.



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