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Asset Management & Investment Funds Update

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Securities Markets Risk Outlook Report 2023: Key Takeaways

On 2 March 2023, the Central Bank published its third annual Securities Markets Risk Outlook Report outlining the key risks and areas of focus for the Central Bank in 2023 (the **Risk Outlook Report**). As summarised below, the Risk Outlook Report highlights eight key risk areas in focus for 2023. The Central Bank expects firms to review the risks and supervisory priorities outlined in the Risk Outlook Report and address these, as appropriate, for example through the alignment of risk assessment and mitigation programmes and compliance plans with regulatory expectations (summarised below).

1. **EXTERNAL RISK ENVIRONMENT**: the Russian invasion of Ukraine, increasing interest rates and soaring inflation have impacted all Irish investment funds but specifically (i) highly leveraged funds particularly those with energy and commodity derivative exposures and LDI funds (following volatility in UK gilt markets) and (ii) less liquid asset funds with daily dealing and specifically high yield corporate bond funds which must factor in the heightened credit risks across portfolios across risk management activities and ensure redemption frequencies are closely correlated to underlying asset liquidity.

   Funds must conduct robust and continuous liquidity stress testing; ensure correct liquidity management tools (**LMTs**) are available to the fund and utilised; verify asset values affected by interest rate increases and sanctions; ensure appropriate sanctions screening of assets and investors.

2. **SUSTAINABLE FINANCE**: investors have high expectations, and it is 'imperative that standards are high so that the sector can support the transition to a more sustainable economy.'

   The Central Bank expects firms to adhere to their regulatory obligations for correct disclosure of sustainability related information in product offerings and to have robust procedures and policies in place to ensure products marketed as 'green' or 'sustainable' meet the criteria to be described as such.

3. **DELEGATION AND OUTSOURCING:** delegation in the funds sector is an area of particular focus and the Central Bank again confirms that it 'does not differentiate between delegation and outsourcing – with the requirements of the Central Bank's Cross-Industry Guidance on Outsourcing applying to both the delegation and outsourcing of activities.'

   The Central Bank expects third party fund managers to increase resources and expertise commensurate with any increase in the nature, scale and complexity of operations. Intra group outsourcing/delegation must be subject to robust governance and oversight, particularly in respect of market abuse surveillance activities. Third party outsourcing of cybersecurity and digital business processes should be monitored for concentration risk, particularly in light of the current geopolitical landscape.

4. **CYBERSECURITY:** increasing reliance on digital platforms, progress on digitalisation, interconnectedness and complexity of securities markets are amplifying risks of ICT/cybersecurity breaches.

   The Central Bank expects firms to have adequate tools and governance frameworks to identify, measure, manage, monitor and report ICT/cybersecurity risks taking account of relevant Central Bank guidance and the provisions of the EU Digital Operational Resilience Act (DORA) (effective January 2025).

5. **DATA QUALITY:** risks arising from the use of inadequate or incorrect data can lead to deficiencies in both firms' and investors' decision-making processes and signal risk management framework issues at the firm.

   The Central Bank expects data submissions to be comprehensive, precise, consistent and timely. Firms must have appropriate oversight of data reporting from Board level down, including where data reporting is outsourced. Data reporting issues must be promptly escalated and addressed, and firms must engage with the Central Bank on data issues as soon as possible to avoid enforcement action.

6. **DIGITAL INNOVATION:** technological innovation must not reduce investor protections.

   The Central Bank expects firms have appropriate governance, cybersecurity, privacy, product and operational risk frameworks to mitigate any operational risks arising from technological innovations.

7. **MARKET INTEGRITY**: risk arising from abusive market behaviours and inadequate firm frameworks to identify, mitigate and manage those risks.

   The Central Bank expects firms to ensure (i) frameworks for the identification, assessment and reporting of suspected instances of market abuse are sufficiently robust to identify, manage and mitigate emerging risks in what is a rapidly changing market environment; (ii) monitor all orders and trades, including cancelled and amended orders; (iii) submit a STOR to the Central Bank without delay once there is a reasonable suspicion that the relevant conduct could constitute market abuse; and (iv) maintain robust frameworks and associated controls to comply with the provisions in MAR concerning inside information.

8. **MARKET CONDUCT RISK MANAGEMENT:** robust governance, control and surveillance frameworks are required to mitigate conduct risks e.g., arising from conflicts of interest or those exacerbated by hybrid working models.

   The Central Bank expects firms to develop and embed more robust frameworks for the identification and assessment of market conduct risks; manage and mitigate emerging risks; and ensure adapted policies, procedures, and controls are in place taking account of hybrid working models, including for recording of telephone and electronic communications.

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