



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem

# Securities Markets Risk Outlook Report

## Conduct Risks in an Uncertain World

February 2021

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## Foreword

In this, the Central Bank of Ireland’s first Securities Markets Risk Outlook Report, we aim to inform regulated financial service providers, investors and market participants of the main conduct risks we see to securities markets, with a particular focus on wholesale securities markets.

In doing so, we also set our high level expectations of what all firms involved in securities markets should do to identify, mitigate and manage those risks in the context of their particular business activities.

As we press ahead with our supervisory work programme for 2021, we will be challenging those we regulate on these expectations. We will take appropriate supervisory action in circumstances where firms have failed to have regard to the risks outlined in this report or where we identify behaviours that fall below our expectations.

To further inform stakeholders, we have also included in this report some of the key areas we will be focusing on in 2021 with specific reference to the risk outlook in this report.

We look forward to working constructively with financial market participants to deliver on our goal of fair, transparent and efficient securities markets.

**Colm Kincaid,**  
*Director of Securities and Markets Supervision*

# Our Mission

The mission of the Central Bank of Ireland is to serve the public interest by safeguarding monetary and financial stability and working to ensure that the financial system operates in the best interests of consumers and the wider economy.

Our work in supervising securities markets is a core part of this mission.

# Introduction

In 2020, the global economic and financial markets narrative was dominated by the onset of the COVID 19 pandemic and the actions of governments and public authorities to deal with it.

Other key topics included the progress of Brexit negotiations, ongoing global trade tensions and the outcome of the US presidential election. All of this took place in the context of securities markets that are increasing in scale and complexity year on year.

Our work in the face of these events focused on targeted interventions to ensure regulated firms dealt appropriately with market reactions to COVID 19 as well as continuing their preparations for Brexit. It also included completing a series of specific supervisory reviews on the management of liquidity in funds and our review of fund management companies' governance, management and effectiveness. We also initiated a series of reviews into how regulated firms and issuers are meeting their obligations under the Market Abuse Regulation (MAR). This included both COVID 19 specific interventions and communications to firms on their MAR obligations, as well as a dedicated industry-wide thematic review, the results of which we plan to announce in 2021.

In 2020, we also saw the implementation of a range of new legislative measures, including new reporting obligations under the Money Market Fund Regulation (MMFR) and the Securities Financing Transactions Regulation (SFTR). Together with existing legislative regimes such as the Markets in Financial Instruments Directive (MiFID) and European Market Infrastructure Regulation (EMIR), this increases again the scale of the data regulators require to discharge their statutory functions and the importance of that data being of good quality. We also saw the continued implementation of the revised Prospectus Regulation, raising the standards required of approved prospectuses and the extent of competent authority scrutiny of those prospectuses before such approval can be granted.

Set against this backdrop, we outline in this report the key areas of conduct risk where we expect to see firms take specific proactive steps in 2021 in how they conduct their business.

## Did you know?

In 2020, the Central Bank approved 717 new investment funds and 906 prospectuses.

## Did you know?

The Central Bank advanced 10 specific work streams in 2020 to implement securities markets legislation.

# Our Five Principles

There is a robust, detailed set of regulatory requirements that apply to securities markets participants including investment funds; trading venue operators; issuers of securities; and investment firms such as asset managers, broker-dealers and market makers.

The requirements are there to ensure proper and orderly markets and to protect the best interests of investors. In our supervision of conduct on wholesale securities markets in relation to those requirements, we are looking to see a market that satisfies five principles:

- 1. It has a high level of protection for investors and market participants.**
- 2. It is transparent as to the features of products and their market price.**
- 3. The market must be well governed (and comprise firms that are well governed).**
- 4. The market must be trusted, by both those using the market to raise funds and those seeking to invest.**
- 5. The market must be resilient enough to continue to operate its core functions in stressed conditions and to innovate appropriately as markets evolve.**

We expect firms to have regard to these principles when conducting business activity and take all necessary steps to ensure they contribute to the achievement of a securities market that adheres to these principles.

# Key Conduct Risks for 2021

Wholesale financial services encompass complex interconnected markets, a wide range of financial products and a large and varied group of professional market participants. The key areas of conduct risk where we expect to see firms take specific proactive steps in 2021 are:

- **Dealing with the impact of external shocks.**  
This includes shocks arising from COVID 19 and Brexit;
- **Successfully managing the migration to greener securities markets;**
- **Managing the increasing complexity in securities markets and the rules that govern them;**
- **Ensuring meaningful transparency for investors and other market participants, in particular on costs and fees;**
- **Understanding the risks and implications of the increased use of indices, as well as being transparent with the market on their use;**
- **Bolstering systems to identify, mitigate and manage misconduct risk, with a particular focus on the risk of market abuse;**
- **Ensuring governance arrangements are fit for purpose and properly resourced, including as businesses expand or change; and**
- **Improving the quality of the data firms use in their business and report to the Central Bank.**



# Impact of External Shocks

All financial market participants are exposed to external risks that can threaten individual firms' business models and can interrupt the smooth and effective functioning of securities markets.

By their very nature, these shocks can result in market impacts that are unexpected (in either scope or nature). Firms need to stress test their operations and plan for these shocks based on plausible worst-case scenarios to ensure they continue to meet their regulatory obligations.



## COVID 19

The COVID 19 pandemic has had a profound effect around the world from a societal, economic and securities markets perspective. At this stage, the long-term impact on business models, market practices and structures of financial service providers remains unclear.

However, we have already seen some of the consequences and risks arising from this external shock across the entire securities markets landscape. Since the onset of the pandemic in early 2020, there was a substantial period of market volatility. Investment fund redemption patterns ran at elevated levels and liquidity concerns arose as investors sold investments to meet their needs and repositioned their portfolios to asset classes they considered safer. This required enhanced monitoring of liquidity risk by firms and regulators, and while funds continued to manage redemption requests adequately, this was done against a backdrop of extraordinary fiscal and monetary support for economies and markets from governments and central banks around the world. Had this support not been there in 2020 the position for funds (as for other market participants) would have been very different. However, this support carries a public cost that has to be factored into our reckoning for the longer term. Even as market conditions have stabilised, securities markets remain vulnerable to further market shocks and economic deterioration.

The pandemic-induced market volatility also affected the operations of essential market structures like trading venues, Central Counterparties (CCPs) and Central Securities Depositories (CSDs). While the providers of these services proved generally resilient in the face of heightened market instability, there were some examples of operational and systems issues across the market as a whole, particularly relating to settlement failures.

Business continuity plans generally worked well, however, certain vulnerabilities were observed. In particular, the episode highlights the need for boards to have dedicated systems to identify and manage risks, together with well-defined

The COVID 19 shock has highlighted vulnerabilities across the securities markets landscape



escalation paths to the board and playbooks in place to deal with worst-case scenarios.

### We expect financial service providers to

- 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.

## Case Study

At the onset of the COVID 19 pandemic, the Central Bank identified a number of priority areas for supervisory focus in its securities markets mandates. Part of this work included being clear with market participants on the issues they needed to prioritise to navigate the challenges presented by the social and economic effects of the pandemic. This included agreeing an EU wide publication from the European Securities and Markets Authority (ESMA) on these priorities, which was issued on 11 March. We also communicated with trading venues and market participants on the need to apply additional vigilance in their reporting and monitoring obligations under Markets in Financial Instruments Regulation (MIFIR), EMIR and MAR. In our communications, we emphasised that regulated firms migrating towards a remote working environment must continue to employ appropriate trade surveillance; including for the detection of market abuse and position limit breaches and the importance of securities markets continuing to function effectively.

In light of the profound economic shock caused by COVID 19, we also monitored the public communications of issuers of financial instruments to ensure that they were meeting their obligations to be transparent to securities markets. This included comparing the practice of Irish issuers with peers internationally, in terms of both size and sectoral focus. Over the period March to July 2020, 66 market announcements of 31 issuers were reviewed in this regard.

Consistent with the ESMA publication of 11 March, as well as intensive engagement with key firms on operational resilience, we increased the intensity of our daily monitoring of markets and intervened with firms where we identified issues of concern. To support this activity, as well as increasing our level of engagement with individual firms (at times to daily or indeed intra daily engagements), we introduced additional reporting requirements in key risk areas such as fund liquidity management and short selling. Consistent with our role as an EU national competent authority and our strategic focus on EU supervisory convergence, this work was done in close coordination with fellow EU regulators and ESMA.

## Brexit

The decision by the United Kingdom (UK) to leave the European Union (EU) will change the structure, composition and operations of securities markets participants in both jurisdictions. The risks arising from this are numerous and cover all aspects of the securities markets landscape.

Brexit makes the UK a third country, impacting on licensing arrangements and resulting in the loss of EU passporting rights for UK firms. It also changes the basis on which EU firms can operate in the UK. It will take time to see how the issues and risks we identified in the run up to Brexit manifest themselves in a post-Brexit environment. Firms can also expect to see increased investor activity, as investors require or wish to reposition themselves in the face of the changed post-Brexit landscape.

We also see the migration of firms and trading activity from the UK to EU member states, including Ireland. This results in new or existing EU firms taking on assets, activities and risks, which are new to these firms, and require the appropriate controls to ensure that conduct risk is managed prudently. There is also the potential for conflicts of interest for staff that may be 'dual hatting' in any business migration transitional period. To identify, mitigate and manage these risks, the firms in question must be properly resourced in terms of both scale and expertise, with clear lines of oversight and escalation. This includes resourcing prudently from the outset to manage the specific risks of migration and the operation of activities in the face of what is a new regulatory and market landscape for all concerned.

Brexit also changes the manner in which EU and UK rules apply to dealing on securities markets, for example under the MiFID share trading obligation and the rules applying to short selling. There is also a heightened risk of market fragmentation and changes to market activity or norms with which we have become familiar over the years, as such activity becomes non-compliant or uncommercial in a post Brexit landscape.

With the UK no longer available as a gateway to the EU, firms will look to other EU member states, including Ireland, as a base to launch products. Again, this can lead to EU firms taking on product lines and related conduct risks with which they are unfamiliar or where changed regulatory obligations or market infrastructure considerations arise in the new post-Brexit landscape.

Firms have done a lot to prepare for Brexit and it has been a supervisory focus of the Central Bank for some time. The effort firms put into preparing for Brexit needs to be replicated now as they experience the realities of operating in the new environment. This requires concrete plans to identify, mitigate and manage the specific risks arising for their firm and the markets

Brexit will affect the structure, composition and operations of securities markets and their participants

### Did you know

ESMA has published a reminder to firms of the MiFID II rules on 'reverse solicitation' in the context of the recent end of the UK transition period.

in which they are active. Brexit has effects immediately upon the UK's exit as well as over the medium and longer term. Firms need to have plans in place for each of these time periods.

### **We expect financial service providers to**

- Ensure they have 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.

# The Migration towards Greener Securities Markets

The evolving climate crisis and the universal need to mitigate its effects requires that financial products and services themselves become more environmentally sustainable. By financing initiatives and trends aimed at stemming the climate crisis, sustainable finance can play a key role in ensuring that securities markets aid the transition to greener economic activities.

The European Commission has established an action plan on the financing of sustainable growth aimed at directing investment capital towards sustainable initiatives. To this end, there is a suite of legislation requiring firms and issuers to make changes to meet these new obligations. This includes the development of a taxonomy that will allow for the classification of sustainable activities, the Sustainable Finance Disclosure Regulation (SFDR) and minimum technical requirements for EU climate benchmarks.

To ensure this transition to a greener financial system is successful, it is imperative that the sustainability features and risks of new products are properly designed and disclosed and that the additional layer of complexity this represents is navigated properly by regulated firms. Special care is needed to avoid misconduct or other investor or market detriment in this arena given the novel and evolving nature of 'green' finance.

We see risks to this successful transition arising where strong investor demand is met by the supply of financial products purporting to be sustainable in nature but which in reality do not meet environmental standards, a practice known as 'greenwashing'. In the context of changing investor demographics and increasing social awareness of sustainability issues, financial market participants may see an incentive to advertise their products and services as sustainable in order to benefit from investor appetite for more sustainable investments. This raises the possibility that investors are misled into buying financial products that do not meet the environmental standards investors expected when making their investment. Firms need to be vigilant to avoid this risk, so that investors' best interests are protected and the reputation of the emerging concept of green finance is not damaged.

In their assessment and mitigation of conduct risk, firms also need to include consideration of climate change and its implications for securities markets and the firm's own business. This includes paying careful attention to



Sustainable finance has a key role to play in combatting climate change

ensuring that the costs, risks and sustainability credentials of their investment products are clearly understood and explained to investors and the market as a whole. Where the sustainability aspect of the product or service is unclear or dependent on future developments, this should be highlighted (recognising that this is an evolving field).

Incoming regulatory changes will aid investors in determining what products are truly eco-friendly while also supplying financial service providers with a clear framework for identifying economic activities that are sustainable. The implementation of these requirements, and fostering greener securities markets more generally, will be a key area of focus for the Central Bank in 2021 and beyond. This will include closely scrutinising applications for authorisation of 'green' funds or securities offerings where prospectus approval is required.

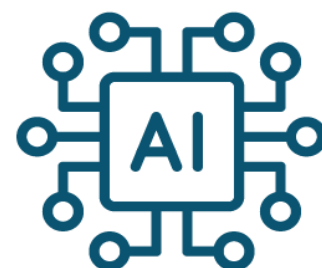
#### **We expect financial service providers and issuers of financial instruments to**

- Review their 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 their preparedness for the transition to greener securities markets, the conduct risks arising within their firm from this transition and how they will identify, mitigate and manage those conduct risks.

Where the sustainability aspect of the product or service is unclear or dependent on future developments, this should be highlighted (recognising that this is an evolving field)

## Increasing Complexity

Global securities markets are becoming more interconnected, complex and sometimes opaque. This, combined with the rise in both the use and sophistication of technology and the increasingly complex design of financial products themselves, gives rise to new risks and amplifies existing ones.



Innovation in securities markets can bring benefits but it also presents fresh risks

The types of financial products offered in securities markets and their level of complexity is constantly evolving. This innovation can bring benefits by diversifying the range of investment products and trading options available for investors and market participants to meet their needs. However, new products and trading options also present fresh risks. In particular, the persistently low interest rate environment has generated a search for yield that incentivises investment in riskier financial products and security types as well as unanticipated changes in market dynamics. We have seen products across securities markets with novel features from crypto assets to more environmentally sustainable propositions, as well as investment funds holding more complex financial instruments and/or pursuing more sophisticated portfolio strategies. The events of 2020 have further illustrated the extent to which the increasing complexity and interconnectedness of securities markets can lead to impacts being transmitted across securities markets in ways that were not expected by those affected.

In an Irish context, these trends are a special area of focus for our work in the field of authorising investment funds under Undertakings for Collective Investment in Transferable Securities (UCITS) legislation, Alternative Investment Fund Managers Directive (AIFMD) and related legislation, where assets under management for Irish domiciled funds has grown from €1tn in 2011 to over €3tn in 2020. It has also become a key area of focus in our role as approver of debt prospectuses under the Prospectus Regulation, where the Central Bank receives an especially high volume of applications. In both fields, this has prompted us to introduce a more systematic risk-based approach to how we assess applications for authorisation, with greater focus on applications with novel features or assets that may pose particular risks to investors in the context of the products' investment profile. Recent topics targeted in this approach have included enhanced scrutiny of UCITS funds that planned to invest significantly in assets where ESMA has issued specific warnings regarding retail investment or where we were not satisfied with how key risks were dealt with and disclosed in the prospectus. It has also

involved ensuring that securities offerings that describe themselves as ‘asset backed’ meet the criteria of having underlying assets and identifiable cash flows as well as ensuring conflicts of interest are properly disclosed.

The market has also become more fragmented, with an increasing number of venues and types of venues where trading can take place. While this adds choice, it can result in dilution of liquidity and add further complexity to market monitoring as trading is taking place across disparate markets, including; regulated markets, Multilateral Trading Facilities (MTFs), Organised Trading Facilities (OTFs) and Systematic Internalisers (SIs). This touches in particular on our principle that securities markets must be transparent as to price formation. In Ireland, there has also been an increase in the infrastructures and range of market participants operating from here, such that a greater degree of trading is now taking place on venues in Ireland that would previously have been transacted in other jurisdictions.

The transition from interbank offered rates (IBORs) towards alternative reference rates also represents a potential conduct risk. These reference rates support a broad range of financial products, from credit instruments to derivatives, and are deeply rooted within the global financial system. The changeover to new reference rates will affect many market participants and a smooth transition by firms is vital to avoid market dislocations, which have the potential to affect market integrity.

### **We expect financial service providers to**

- Ensure products they produce 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. Their 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 their business activity and to have a plan to mitigate those risks, including appropriate communication and disclosure to clients.



## Case Study

The Central Bank has a gatekeeper role as competent authority and is responsible for the authorisation of investment funds under UCITS, AIFMD and related domestic funds legislation. It is also responsible for the scrutiny and approval of prospectuses under the Prospectus Regulation.

In applying our gatekeeper role in these areas, we have developed the following set of gatekeeper principles under the ROBUST acronym. Our ROBUST principles guide us in the assessment of applications to ensure that appropriate challenge is provided on applications at the point of entry:

- **Risk based:** We will place primacy on the review of issuances/funds intended for retail investors and will apply a higher level of scrutiny and challenge to submissions that pose higher risk.
- **Outcome focused:** Our scrutiny will place emphasis on high quality outcomes for investors and market integrity.
- **Best practice led:** We will conform to EU and international best practice in our regulatory approach.
- **Use our resources to best effect:** We will allocate resources to areas of priority or risk identified. We will endeavour to deliver on service standards but this intention must not undermine the quality of reviews.
- **Stakeholder engagement:** We will ensure that any stakeholder engagement undertaken is purposeful and for the protection of investors.
- **Trusts but verifies:** We will place greater responsibility on applicants to demonstrate compliance and require verification, where appropriate.

# Transparency

Central to our five principles is the concept of a market that is transparent as to the features of products and their market price. It is essential that investors and market participants can make informed decisions based on available information and reliable pricing.



## Costs and Fees

Transparency in the cost and fee structures of financial services and products is key to confidence and trust in securities markets. Irish and EU regulations include detailed obligations with regard to disclosure of costs and fees. A lack of transparency in these costs and fees can have a significant detrimental effect on the efficiency with which markets transmit money from investors to those who access securities markets to raise funding for the real economy (and back again). Ultimately, this affects the value received from securities markets by investors, issuers and other market participants. As such, it has a direct impact on the proper performance of securities markets' core investment functions and is contrary to our five principles.

Clear and meaningful disclosure of costs and fees is therefore key to ensuring that investors and other market participants are suitably equipped to make fully informed decisions. In particular, lack of meaningful transparency around costs and fees leads to (i) investors and other market participants miscalculating the return they will receive and thereby the extent to which the product will meet their financial needs and (ii) investors and other market participants choosing a product that is less suitable for their needs than another product available on the market. For disclosure of costs and fees to be meaningful, it is also important that the services received for those costs and fees are clearly explained and that key risks are prominently disclosed.

Transparency in costs and fees can be seen therefore as a key part in achieving the strategic aim of EU Capital Markets Union, not least in respect of investment funds where Ireland plays a particularly significant role. Based on our supervisory work to date, it is clear that many firms still have a journey to travel regarding transparency of costs in the investment products they offer.

Transparency in the cost and fee structures of financial products is key to confidence and trust in securities markets

### Did you know?

The Central Bank has recently undertaken a review to identify and prevent closet indexing. This review resulted in the issuance of over 80 risk mitigation actions to in scope firms.

## We expect financial service providers to

- 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.

## Index Providers

Over the last decade, financial indexing strategies have grown in importance with their increased utilisation and complexity. Asset managers, both as investors and market participants, have shifted to more passive index-based techniques grounded in reduced costs and historic performance. There is a body of regulation regarding indices including the Benchmarks Regulation, ESMA guidelines and sectoral legislation (e.g. in UCITS).

The move away from active stock selection towards indexed-based strategies, including in investment funds, has increased the role of indices and index providers and their impact on the global flow of investment capital.

This prompts questions regarding the extent and implications of firms' reliance on indices and index providers, transparency of the investment methodologies at index providers, potential conflicts of interest and how costs are disclosed to investors and other market participants.

It has also featured in our recent work on 'closet indexing', where we found cases where investment funds charged for an active investment strategy while in fact tracking an index in a manner that had not been properly disclosed.

## We expect financial service providers to

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

The growing importance of index providers in global finance has highlighted potential areas of concern for regulators

### Did you know?

Market data shows the majority of Irish UCITS now reference an index when measuring their performance.

## Case Study

As we continue to implement new legislative mandates under our remit, our work processes are also adjusted to take these new requirements into account. In 2020, this approach was apparent in our application of the Benchmarks Regulation (BMR). The BMR aims to reduce the risk of manipulation of benchmarks by addressing conflicts of interest, governance controls and the use of discretion in the benchmark-setting process. It requires EU administrators of a broad class of benchmarks to be authorised or registered by a national regulator and to implement governance systems and other controls to ensure the integrity and reliability of their benchmarks. The BMR also introduces a regime for third country benchmarks. In order to assess benchmark administrators, the Central Bank created a BMR specific risk taxonomy mapped to the requirements in the BMR. Applications from administrators are validated against the taxonomy, which is also utilised for ongoing supervision purposes. To date, this taxonomy has been deployed in four such application processes and one targeted supervisory assessment of a benchmark administrator.

# Misconduct Risk in Securities Markets

Misconduct on securities markets undermines transparency and trust amongst market participants and is detrimental to investor protection. As a conduct regulator, we assess market wide conduct risks across the full range of market participants.



## Market Abuse

For investors and other market participants to have trust in securities markets they have to know that the market is transparent. A key part of this transparency is knowing that issuers are meeting their obligations to disclose relevant information to the market in a timely and comprehensive manner. This includes the obligations under MAR and related market abuse legislation on managing and disclosing inside information.

Risks exist that issuers are not transparent in their communication to the market and therefore investors make uninformed investment decisions. This risk is heightened in a context where the incidences of inside information requiring disclosure are likely to be more widespread in the face of COVID 19, as the pandemic continues to materially affect firms and as companies seek to raise additional capital.

Risks also exist that regulated firms' surveillance systems are not effective in detecting abusive trading behaviours, eroding trust in the integrity of securities markets. Market operators and investment firms are required by legislation to have effective systems in place for the detection and prevention of abusive market behaviours, such as insider dealing and market manipulation. In markets that are volatile or have increased trading volumes, there is an increased risk that abusive behaviours go undetected as firms deal with exponential increases in alerts from their surveillance systems.

As well as heightening the risk of market abuse itself, the onset of COVID 19 and the resulting paradigm shift in our collective working arrangements has presented new challenges for firms in meeting their obligations to monitor and ensure compliance with market abuse legislation.

The onset of COVID 19 has presented new challenges for firms meeting their obligations under the Market Abuse Regulation

### Did you know?

During two weeks of market turbulence in March 2020, daily transactions reported to the Central Bank were 3 times greater than their pre-COVID 19 levels and following the announcement of results of the US Presidential election they were more than double the normal level.

## We expect financial service providers and issuers of financial instruments to

- 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 they have 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.

## Governance

If investors, issuers and other market participants are to have trust in the conduct of the firms that operate in securities markets, those firms need to meet the highest standards of governance. This is all the more so as the scale and complexity of securities markets activity continues to grow. Necessary reforms have also increased the scale and complexity of the regulatory framework in accordance with which firms must conduct their business, again increasing the need for the highest standards of governance to ensure compliance with these requirements.

All of this necessitates of course that each regulated entity has resources of sufficient scale and expertise to manage the activities of the firm. Where the execution of tasks is outsourced/delegated to other parties, the regulated entity must make sure it has sufficient resources in the regulated entity itself to manage these arrangements and oversee outsourcees/delegates and the conduct risks arising.

We continue to see risks arising from failings related to board oversight of their outsourcees/delegates and third party intermediaries. This includes cases where firms are receiving these services from other entities within their corporate group. We remain concerned that some boards see the oversight of these intermediaries' delegated activity and their adherence to relevant legislation as the sole responsibility of their outsourcee/delegate. We remind firms that they can outsource/delegate the performance of tasks but they cannot outsource/delegate their regulatory responsibilities with respect to those tasks and the conduct risk arising from them.

As financial service providers' reliance on outsourced services continues to grow, so does the obligation to manage the resulting risks

A central theme of our five principles is securities markets that are resilient in times of market or operational stress, and regulated entities in each securities market sector are subject to specific obligations to manage this risk for their firm. The recent COVID 19 period has further highlighted the level to which financial service providers rely on outsourcing arrangements for business activities and the need to ensure that proper oversight and governance arrangements are in place to avoid service disruption. While on the whole business continuity arrangements worked well in the face of extraordinary circumstances, the COVID 19 experience also identified vulnerabilities that firms need to address.

In addition, we see risks arising from circumstances where firms fail to ensure that conflicts of interest are managed properly. In particular, connected party transactions must be identified and carried out at arm's length and in a manner that ensures the best interests of investors and market integrity are protected.

We have observed senior staff reporting directly to heads of business divisions located outside Ireland, bypassing local management. This demonstrates an inadequate governance structure in the Irish regulated entity, and perhaps a failure at group level to respect the separate legal existence and regulatory responsibilities of the Irish regulated entity. In some cases, it has also highlighted that the resource in the Irish regulated entity is inadequate to avoid such risks. We also continue to identify instances across all the securities markets sectors we regulate where staff within regulated entities are unclear on the specific roles and responsibilities for managing market conduct risk within their firm.

The Fitness and Probity Regime is a key component of the framework designed to protect investors and market participants from the consequences of poor governance and misconduct. Where properly implemented, it provides a strong framework to mitigate many of the risks referred to in this report. However, we continue to identify deficits in firms' understanding of their ongoing obligations, for example in assessing controlled function holders' fitness and probity.

### **We expect financial service providers to**

- Ensure they have 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 their obligations under the Fitness and Probity Regime including as it applies to controlled functions that are not pre-approval controlled functions.

## Case Study

Together with fellow NCAs and ESMA, in 2020 the Central Bank commenced an EU wide 'Common Supervisory Action' (CSA) on UCITS liquidity management following a number of liquidity issues within UCITS funds that resulted in investors being unable to redeem their holdings and ultimately incurring a significant loss on their investments. A CSA is a new type of supervisory exercise whereby ESMA and NCAs coordinate a thematic review of a given topic of special importance.

The CSA involved industry participants completing questionnaires on their liquidity risk management frameworks and supplying both quantitative and qualitative information to the Central Bank. Following this, the Central Bank undertook an in depth supervisory review of 55 UCITS managers, which included an examination of key indicators, specific datasets and direct engagement with UCITS managers.

A public communication on the results of this CSA is due in 2021.

# Data Quality

Accurate and complete data is essential in identifying risks and discharging our supervisory responsibilities.



The increasing size and complexity of securities markets is being driven, in part, by faster and more voluminous transactions which has in turn been fuelled by increased levels of automation. This increases the scale and complexity of the data firms need to collect, hold and understand in order to identify, mitigate and manage conduct risk. It has also led to a significant increase in the regulatory reporting obligations of firms under a broad range of legislation such as MIFIR, EMIR, SFTR, AIFMD and MMFR, to equip regulators to supervise this activity effectively and identify trends where supervisory mitigation or further reform might be required. It is critical for firms to have systems and controls in place that are fit for purpose to meet this challenge, especially as firms seek to grow or change their business activities.

Data is a vital and increasingly important aspect of our supervisory toolkit. This makes data quality paramount.

This includes devoting sufficient attention to ensuring that the data being used by the firm and reported to the regulator is accurate. We continue to identify submissions that are incomplete or incorrect, as well as instances where firms have not had data available for the Central Bank when requested. The COVID 19 induced market dislocation during 2020 further highlighted weaknesses in data quality within firms, as the rapidly evolving situation required the Central Bank to make additional data requests. Firms had to react quickly to these additional demands, and overall firms managed to do so. Nevertheless, it was clear that some firms were better equipped to meet this challenge than others, raising questions about the availability and quality of data used within certain firms for their own risk management processes. We also encountered too many cases where the Central Bank identified errors within the data that required it to be checked by the firm and re-submitted.

## Did you know?

We receive and process over 5 million financial derivative reports every day representing a notional value of over €7 trillion for Irish counterparties.

### We expect financial service providers to

- 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.

# Securities Markets Conduct Supervision Priorities 2021



Our supervisory priorities are informed by our assessment of conduct risks arising in the securities markets we supervise. This includes having regard to the risks highlighted in this report, our work with fellow regulators and ESMA colleagues and the priorities of the Central Bank's Strategic Plan 2019-2021.

2021 will see us progressing a range of supervisory actions to systematically target and mitigate key risks, implementing our ROBUST Gatekeeper principles and related ways of working and further embedding our use of data analytics.

This body of work will include actions to deal with the impact of COVID 19 and Brexit. It will also include a series of high quality supervisory actions, using the tools and principles of our new supervisory approach to wholesale market conduct risk. As well as our ongoing trigger-based supervision of conduct risk in securities markets, this will include launching a number of thematic reviews and follow-up actions specific to the conduct risks outlined in this report.

One such area of focus is the field of market abuse. In 2020, the Central Bank initiated a supervisory review of compliance with MAR requirements for issuers and those that act on their behalf, on the main Irish regulated market. The review focuses on the extent to which participants comply with requirements to recognise, manage and in the case of issuers, publicly disclose inside information in accordance with applicable legislation. At the same time, we commenced a supervisory review on the practice and governance of detecting and reporting suspected market abuse. This review includes a focus on how these arrangements evolved during the recent period of extreme market volatility. In 2021, one of our supervisory priorities will be to complete these reviews and take appropriate action on foot of our findings.

We will also follow through on findings from our 2020 thematic reviews in the funds sector. This includes the findings from our review of Fund Management Companies' Governance, Management and Effectiveness and the ESRB/ESMA Review of Corporate Bond and Property Funds. We will also complete our follow up actions to the ESMA CSA on Liquidity Management in

UCITS and launch a new CSA along with ESMA colleagues and fellow EU regulators, this time in the field of UCITS costs and fees.

2021 will also see us advance our application of our Gatekeeper ROBUST Principles and ways of working, including applying the risk outlook in this report to identify areas for enhanced scrutiny. We will also complete work to automate transmission of data and documentation to ESMA, review our Prospectus Fees and Service Standards and participate in the ESMA Peer Review on the Prospectus Regulation.

We will continue to build an approach that is more data driven by building on the work of 2020 to enhance our processes for market monitoring and reactive supervisory intervention, with a particular focus on investment funds. To support this, data quality will become an increasing area of focus for the Central Bank and ESMA has identified it as a Union Strategic Supervisory Priority. Our work in 2021 will therefore include conducting a series of actions on data quality in conjunction with ESMA and fellow NCAs.

2021 will be another year of substantive projects to implement securities markets legislation and related technical standards and guidance. This will include in particular further implementation of the MMFR and SFTR requirements as well as continued work with ESMA to improve the data architecture that supports our work. We will also commence work to support the creation of a central ESMA database of funds marketing throughout the EU.

Finally, the Central Bank's supervisory work and insights will feature prominently in our wider policy work at domestic and international level, bearing in mind the significant scale of the Irish securities markets industry and its global nature. Key topics where our supervisory perspectives will inform work in 2021 will include:

- work on potential reform of the framework for money market funds and the wider consideration of a better macro-prudential framework for investment funds;
- reviews of MAR, MIFID and AIFMD;
- the development and implementation of the framework for sustainable finance;
- work with our colleagues at the International Organisation of Securities Commissions (IOSCO) undertaking a review of conduct-related issues in relation to index providers, with a specific focus on the asset management industry;
- enhancing international coordination in the supervision of conduct risk in wholesale securities markets, with a particular focus on improved EU supervisory convergence and continued cooperation under the IOSCO Multilateral Memorandum of Understanding.

#### Did you know?

In 2020, the Central Bank received 18 requests for assistance from other securities markets regulators.

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