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BY EMAIL

11 March 2019

RE: WHOLESALE MARKET CONDUCT RISK – INDUSTRY COMMUNICATION

Dear CEO

The Central Bank of Ireland (the **Central Bank**) is the competent authority in Ireland for wholesale market conduct supervision under a range of legislation[1]. By comparison to retail financial services, wholesale financial markets encompass complex interconnected markets, a wide range of financial products and a large and varied group of professional market participants. The scale and global nature of wholesale financial markets, their opaqueness, the sophistication of the activity involved, and the speed of change also contribute to the complexity of these markets. All of these features combine to create distinct market conduct risks.

Due to the increase in scale and sophistication of wholesale financial market activity carried on in and from Ireland and by branches of Irish firms in other jurisdictions, the Central Bank is developing new, more systematic capabilities to supervise conduct in wholesale markets. A specialised team, the Wholesale Market Conduct Team, has been established, tasked with carrying out market conduct risk assessments of firms engaging or applying to engage in wholesale market activity. The Central Bank intends, by this letter, to engage with existing and incoming firms and set out its expectations in respect of how these firms identify, mitigate and manage market conduct risk.

[1] Including but not limited to: MiFID II related legislation, the Market Abuse Regime, the Central Bank Reform Act 2010, and, where relevant, the Capital Requirements Regulation and Capital Requirements Directive IV, the Investment Firm Regulations 2017, the European Market Infrastructure Regulation, the Central Securities Depositories Regulation and the Securities Financing Transaction Regulation.

<u>Actions required</u>

Your firm should:

1. Review the **Expectations** set out below to ensure the firm understands, implements and satisfies the Expectations;
2. Take all necessary steps to ensure that market conduct risks, to which the firm is exposed, are understood, mitigated and managed appropriately; and
3. Address any misalignments between the firm's internal frameworks and practices and the Expectations, and establish the necessary processes to ensure that the firm continues to meet the Expectations on an ongoing basis.

Market Conduct Risk Expectations (the Expectations)

Under the MiFID regime, investment firms and credit institutions carrying on investment services and activities must establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the firm with its obligations, and put in place adequate measures and procedures designed to minimise such risk, and to enable competent authorities to exercise their powers effectively. This over-arching obligation under the MiFID regime sits alongside the specific obligations under a range of legislation relating to firms and individuals within firms, including other specific regulatory requirements pertaining to wholesale market activity.

At a minimum, firms must be able to demonstrate and evidence how the frameworks, policies, procedures and practices formally adopted and utilised by the firm in respect of market conduct risk address the following:

- **Market Conduct Strategy**
    1. How the firm defines its own market conduct risk.
    2. How management of market conduct risk is embedded in the strategy of the firm including (i) the consideration of market conduct risk in strategic planning (including annual planning and budgetary processes), (ii) how the firm formally assesses market conduct risks inherent in the firm's strategy and target outcomes and; (iii) how this is communicated to staff across all business lines, including front office and client facing

staff. In circumstances where the firm is part of a multinational group, the extent of reliance by the Irish firm on the group, in addition to the extent of input from the Irish firm, in the embedding of the conduct risk management process, will be considered.

3. Where the firm books risk to its balance sheet, the firm must be able to demonstrate how it manages and mitigates market conduct risk, including the ability to reject group / intra-group business.

- **Governance and Organisation**

4. (i) How market conduct risk management and mitigation is included in the objectives for senior management and (ii) the extent to which senior management or relevant decision makers have knowledge, expertise and capability to make business decisions for the local entity within the broader group (where applicable).
5. Embedding of market conduct risk within the firm's governance structure including clarifying responsibilities and accountabilities for managing and mitigating market conduct risk at Board and executive committee levels.
6. The articulation of market conduct risk in roles and responsibilities for business, control and audit functions (the first, second and third lines of defence).
7. The firm's capacity for managing market conduct risk, and how market conduct risk is considered in the establishment of reporting lines, escalation paths and outsourcing arrangements.
8. Ensuring there is effective oversight of activities conducted at branches of Irish firms in other jurisdictions and / or by affiliates (for example through outsourcing arrangements). Where appropriate, market conduct issues relevant to the firm must be notified to the Central Bank in a timely fashion, whether the conduct occurs in Ireland or other jurisdictions.

- **Risk Management**

9. How the firm classifies market conduct risks (e.g. using a taxonomy / inventory or by some other means).
10. The market conduct risk identification processes used by the firm, including (i) the formal scheduling of the processes, (ii) the inclusion of front office / client facing staff in the processes and; (iii) actions taken as a result of the identification processes.

11. Controls design and testing including (i) the formal documentation of the control environment, (ii) the scheduling of control testing and; (iii) the mapping of controls to market conduct risks identified.

- **Culture and People**

12. How the firm builds on shared purpose and standards such as professionalism, honesty, integrity and accountability.
13. People management including (i) the use of financial and non-financial performance measurements, (ii) how business is conducted and; (iii) the treatment of market conduct risk throughout the employee life cycle.
14. The communication strategy across the three lines of defence to consistently reinforce tone from the top, the ethics, values and behaviours expected of staff and the specific market conduct risks applicable to the Firm.
15. Training and development for education of staff in relation to behaviour and the management of market conduct risk including (i) scheduling of training programmes, (ii) performance implications for non-completion and; (iii) input and evaluation from the first line of defence.
16. How the firm meets its obligations under the Fitness & Probity regime[2], which was introduced to ensure that individuals working in financial services are competent and ethical.

- **Metrics and Monitoring**

17. Market conduct risk metrics and reporting including (i) management information for the Board and senior management and (ii) triggers for escalation, follow-up actions and changes to policies, procedures and controls.

Continued Engagement

Boards must develop and maintain the appropriate governance frameworks in order to meet the regulatory requirements on a continuous basis and embed a positive conduct culture within their firm. It

[2] Information on Fitness and Probity for Regulated Financial Service Providers can be found here: https://www.centralbank.ie/regulation/how-we-regulate/authorisation/fitness-probity

is critical that the Board has confidence that the policies and procedures it has approved are being implemented in practice and assessed via appropriate second line monitoring.

Conclusion

The Central Bank requires the firm to provide a copy of this letter to its Board at the next meeting following the date of this letter and for the resulting discussions to be reflected in the minutes of that board meeting. The Central Bank will continue to engage with industry in relation to market conduct risk in line with the Central Bank's stated aims for authorisations and supervisory engagement. The firm is not required to respond to this letter.

In circumstances of non-compliance by a firm with any regulatory requirements relevant to the matters raised in this letter, the Central Bank may, when exercising its supervisory and / or enforcement powers, have regard to the consideration given by the firm to the matters raised in this letter. Matters raised in this letter may be considered in respect of future inspections of the firm by the Central Bank.

Should you have any queries regarding the content of this letter please contact wholesaleconduct@centralbank.ie

Yours sincerely

Derville Rowland

Derville Rowland
Director General Financial Conduct