Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

T +353 (0)1 224 6000

Bosca PO 559
Baile Átha Cliath 1

PO Box 559
Dublin 1

www.centralbank.ie

[CEO]
[COMPANY]

BY EMAIL

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CENTRAL BANK OF IRELAND - MARKET ABUSE THEMATIC REVIEW
TRADE SURVEILLANCE AND REPORTING OF SUSPECTED MARKET ABUSE

Dear CEO

The Central Bank of Ireland (Central Bank) is the competent authority in Ireland for the Market Abuse Regulation (MAR).[1] In 2020, the Central Bank commenced a thematic review (Review) to assess the effectiveness of trade surveillance frameworks used by firms to identify instances of suspected market abuse and to report those suspicions to the Central Bank. This work was a component of a wider thematic review of compliance with MAR, including the obligations of issuers and their advisors.

Market abuse is unlawful behaviour on financial markets. It comprises insider dealing, unlawful disclosure of inside information, market manipulation or related attempts. Market abuse undermines market integrity and investor confidence. The increasingly global nature of financial markets has led to new trading platforms and technologies which present new opportunities to manipulate markets. The scale and sophistication of relevant securities activity carried on by regulated entities in and from Ireland has also increased. These factors combine to result in an increase in Irish regulated entities' obligations to identify, mitigate and manage market abuse risk in a manner that is effective, having regard to the nature, scale and complexity of their operations.

The Central Bank is focused on ensuring that, as our securities markets develop, firms implement effective frameworks to identify and report incidences of suspected market abuse. This requires that firms implement effective surveillance systems and governance arrangements, raise market abuse risk awareness among staff and maintain sufficient human and other resources.

The Review assessed compliance with Article 16(2) MAR. This Article requires any person that professionally arranges or executes transactions in financial instruments subject to MAR to

[1] Regulation (EU) 596/2014 and Regulation 3 European Union (Market Abuse) Regulations 2016 (S.I. No. 349 of 2016).

establish and maintain effective arrangements, systems and procedures to detect and report suspicious orders and transactions. Where that person reasonably suspects an order or transaction could constitute market abuse, it must submit to the Central Bank, in the prescribed format, a Suspicious Transaction and Order Report (STOR). These obligations apply broadly, including to buy side firms such as asset managers (including AIFM and UCITS managers) and entities that trade on own account, whether or not the entity requires to be authorised by the Central Bank in order to carry on that activity.[2]

The Central Bank carried out in-depth assessments of 6 firms, including 29 virtual engagements with frontline staff, senior management and compliance personnel. The Central Bank observed some good practices, such as risk assessment processes tailored specifically to the firm's particular exposure to market abuse risk and active monitoring and dissemination of EU enforcement cases. However, the Review also identified deficiencies in firms' risk assessments, trade surveillance systems and MAR compliance frameworks, requiring entity-specific risk mitigation programmes for most firms assessed in the Review. This letter sets out the Central Bank's key findings and expectations arising from the Review.[3]

KEY FINDINGS AND EXPECTATIONS

1. Firms must improve their frameworks to identify and mitigate market abuse risk

Central Bank industry communications in 2019 and 2020[4] emphasised the identification and assessment of conduct risks as fundamental to the implementation and maintenance of a robust market conduct risk framework. The Review found evidence of deficiencies in this regard, including:

- Failure to implement a structured and effective market abuse risk identification and assessment process, which considers all potential market abuse risks relevant to a firm's specific business model and activities.
- Absence of clear documentation detailing the materiality of the risks identified, including an assessment of the impact and likelihood of each risk occurring.
- Lack of staff awareness of the critical role they play in the first, second and third lines of defence in the detection, monitoring and reporting of suspected incidences of market abuse.
- Staff training that was generic, not targeted to a firm's particular business model and market operations and therefore did not adequately prepare staff to deal with the market abuse risk facing them.

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[2] See response to Question 6.1 ESMA Questions and Answers on the Market Abuse Regulation Version 14, 29 March 2019, available here.

[3] The Review and key findings align with the Central Bank's Five Principles for a Proper and Effectively Regulated Securities Market, available here.

[4] Wholesale Market Conduct Risk 2019 Industry communication, available here. Securities Market Conduct Risk 2020 Communication, available here.

The Central Bank expects firms to:

- Implement a documented process to identify all market abuse risks specifically applicable to their business model, consider the materiality of those risks and take steps to mitigate and manage those risks. For example, front running is an inherent risk at firms who transmit orders, irrespective of senior management's confidence in the integrity of its staff. The process should include an annual review as well as a review of market abuse risk in the case of any business model changes or business expansions.
- Improve staff awareness of the role they play in the detection and assessment of market abuse risk. This includes providing regular, business model-specific and comprehensive market abuse training to all staff, including front office and compliance staff. The measures taken should ensure staff are competent to identify and escalate incidences of suspected market abuse.

2. Firms must improve the efficacy and integrity of their trade surveillance systems

Effective trade surveillance systems are critical to the mitigation of market abuse risk. The Review identified failures in the effectiveness and integrity of post-trade surveillance systems, including:

- Surveillance systems did not cover all relevant market abuse behaviours applicable to firms' specific business models and market activities.
- Absence of effective surveillance alerts, including deficiencies in the calibration of alert parameters and thresholds. Poor practices included adjusting alert calibrations to reduce the volume of alerts to reflect resource constraints. This reduces the system's effectiveness in detecting market abuse.
- Absence of surveillance system access controls. For example, firms permitted staff to disable alerts or change thresholds without providing rationale or being subject to four-eye approval. This may result in inappropriately calibrated alerts.
- Absence of control testing by compliance, risk and audit functions to ensure the suitability of each alert parameter. This results in insufficient oversight and monitoring of exposure to market abuse, and limits firms' awareness of relevant market abuse risk.

The Central Bank expects firms to:

- Implement and maintain a robust and effective surveillance framework to detect and report suspected market abuse. This includes a trade surveillance system that aligns to the firm's specific business model and activities.
- Calibrate alert systems appropriately to the nature and scale of the firm's activity and ensure that changes are justified, having regard to the firm's obligations under MAR, and documented accordingly.
- Implement robust quality assurance processes to ensure they raise, meet and maintain appropriate compliance standards.

3. Firms must enhance their governance arrangements for trade surveillance

The Review identified deficient governance of trade surveillance and reporting activity, including:

- Lack of clearly defined roles and responsibilities for the detection and escalation of suspected market abuse. This leads to a lack of staff awareness of their MAR obligations and poorly embedded surveillance frameworks.
- Lack of formalised governance procedures for setting or changing surveillance alert parameters.
- Insufficiently detailed market abuse policies. This leads to inconsistencies in knowledge, understanding and competence across sales, trading or other frontline functions and the absence of consistent and appropriate review standards by compliance, risk and/or audit.

The Central Bank expects firms to:

- Assess their governance arrangements for ensuring their compliance with legal and regulatory obligations to detect and report market abuse.
- Implement detailed policies that ensure a consistent level of understanding of the arrangements by frontline staff (operating in both on-site and virtual environments) and the maintenance of an alert review standard.
- Appropriately govern the amendment of parameters and alert thresholds.

4. All firms must assess and enhance their resourcing arrangements and avoid key person risk

The Review identified resourcing constraints that impeded the ability of compliance functions to monitor effectively for market abuse risk, including:

- Not enough skilled staff, inadequate systems and arrangements, or a combination of both.
- Inadequate resourcing in compliance functions leading to backlogs of alert reviews.
- Lack of documented procedures for specific market abuse related tasks completed by key personnel. This increases key person risk in market abuse monitoring.

The Central Bank expects firms to:

- Assign dedicated and competent resources, including human resources, to the daily management and supervision of market abuse surveillance, relative to the firm's nature, scale and complexity. Firms should note in this regard that the Central Bank identified a need for greater resourcing in all of the firms it assessed in the Review.
- Ensure that resource takes a proactive approach to support the firm's surveillance framework and regularly considers the potential impacts that new and existing market abuse risks could have on the firm and the overall market.

5. Firms must improve the quality, frequency and distribution of Management Information (MI)

Informative MI enhances oversight and informs independent challenge from the audit function, senior management and the Board. It can also create efficiencies in the market abuse control environment. The Review identified deficiencies in this regard, including:

- Absence of formal, regular and effective MAR-related MI.
- Inability to demonstrate discussion, challenge or analysis of trade surveillance MI at board level.

The Central Bank expects firms to:

- Generate and use MI that is specific to market abuse risk, accurate, timely and relevant to the business of the firm and the specific risks it faces.
- Ensure that boards and senior management use that MI to assess, challenge and manage market abuse risk.

6. Firms should examine the volume of Suspicious Transaction and Order Reports (STORs) they submit against the volume and complexity of their orders and transactions

STORs are fundamental to the Central Bank's ability to detect abusive behaviour and to intervene and investigate market abuse. As such, they are a vital source of information for the Central Bank. Effective STOR reporting is also essential to a firm playing its role to support the prevention and investigation of market abuse.

Since 2018, the volume of transactions reported to the Central Bank pursuant to the MiFID regime have increased in number year-on-year but the volume of STORs submitted pursuant to MAR have declined by almost 30% over the same period. This has happened notwithstanding substantially increased transaction volumes in the wake of higher volatility during the pandemic. This fall in STOR volumes may indicate a failure by firms to keep their processes up to date with the volume of their trading activity.

In light of this trend and the findings of the Review, the Central Bank expects firms to review compliance with their Article 16 MAR obligation to submit STORs to the Central Bank in order to ensure that the volume of STORs they submit is appropriate to the nature and scale of their business.

NEXT STEPS AND ACTIONS REQUIRED

As a result of these findings, the Central Bank has commenced supervisory engagement with those firms where specific concerns have been identified, including the imposition of specific risk mitigation programmes with respect to those concerns.

Whether or not a firm has received a specific risk mitigation requirement from the Central Bank, all firms that professionally arrange or execute relevant transactions are required to critically assess their activities, frameworks, organisational arrangements and controls against the findings and expectations in this letter and put in place a time bound plan to remediate deficiencies. The Central Bank expects this plan to be discussed and approved by your board by the end of 2021. The Central Bank may have regard to the content and quality of such assessments and plans in future reviews of a firm's compliance.

In circumstances of non-compliance by entities with 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 an entity to the matters in this letter. Please address queries regarding this letter to MARThematic@centralbank.ie. You are not required to respond to this letter.

Yours sincerely

Colm Kincaid.

Colm Kincaid
Director of Securities and Markets Supervision