# Conducting your business well – regulatory scrutiny on conduct risk

The Central Bank has sharpened its focus on conduct risk since its financial conduct pillar was established in 2017. While initially the focus was on conduct risk in the retail sector, the Central Bank is now also looking at how firms which engage in wholesale market activity manage this risk. MUIREANN REEDY looks at developments in the area and says firms should be ready to demonstrate to the regulator how this risk is being managed.

**Central Bank restructure**

One of the first signals that the Central Bank of Ireland (the "CBI") was sharpening its focus on conduct risk, came in May 2017, when the CBI announced that it was restructuring its financial regulation function to include a new pillar – financial conduct. The new role of Director General (Financial Conduct) was created, to which Derville Rowland (former Director of Enforcement) was appointed. The Governor said that the purpose of the restructure was to emphasise the importance of the CBI's financial conduct mandate.

**Consumers**

In 2017 the CBI launched its consumer protection risk assessment model. It said a new and more intrusive approach for supervisory assessments of firms had been established, concerning conduct and consumer protection risk management.

A year later, the CBI flagged in its report on "Behaviour and Culture of the Irish Retail Banks" that it would be increasing its focus on conduct risk. It warned that the highest impact firms from a consumer perspective could expect more frequent use of the consumer protection risk assessment model and increased challenge of boards and executive management, with specific emphasis on behaviour and culture. It also acknowledged that the CBI had broadened its supervision of consumer-focused conduct risk from looking at the nature and scope of a firm's products, and the risks associated with them, to consumer risks which could stem from other sources within a firm such as strategy, business model, culture and governance, as well as the behaviour of individuals within the firm.

**Wholesale markets**

More recently, the CBI has expanded its focus to conduct risk in the wholesale market. This was evidenced by the establishment of a new Wholesale Conduct Function in 2018 which is tasked with carrying out market conduct risk assessments of firms engaging, or applying to engage, in wholesale market activity.

Muireann Reedy

Last March the CBI issued a "Dear CEO" letter on wholesale market conduct risk. The CBI noted that distinct market conduct risks were attributable to wholesale markets arising from a combination of factors, including their scale, opaqueness, the sophistication of the activity involved and their global nature. The letter stated that wholesale firms must be able to evidence how the frameworks, policies and procedures used in relation to market conduct risk addressed various issues set out in the letter. These include how the management of market conduct risk is embedded in the firm's strategy and in its governance structure and how market conduct risks are classified. The CBI also made it clear that it expects firms to have policies and procedures in place to evidence how market conduct risk is treated through the employee life cycle.

This was followed up in January this year by a "Dear CEO" letter on securities market conduct risk. That letter set out the CBI's findings from a 2019 thematic review which assessed regulated entities' effectiveness in identifying and assessing market conduct risk. The CBI stated that it expected regulated entities to have market conduct risk frameworks fully embedded into their organisational arrangements, along with appropriate controls which their employees understood. It emphasised its expectation that boards and senior management should take full ownership of market conduct risk governance, including challenging group decisions where appropriate. The letter also reminded firms of the importance of complying with its Fitness and Probity Regime at local and branch level. The CBI also noted that regulated entities, issuers and those acting on behalf of issuers (whether regulated or not) must have systems and controls in place to ensure compliance with their obligations under the Market Abuse Regulation and related legislation.

The CBI also confirmed that its supervisory work in 2020 will focus 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. It also stated that it expected to devote "considerable" supervisory resources in the year ahead to examining the compliance by regulated entities and issuers with their obligations to recognise and manage inside information, and the requirement on regulated entities to identify suspicious transactions and orders.

**Non-Financial Misconduct**

Across the sea, the UK Financial Conduct Authority (the "FCA") recently issued a "Dear CEO" letter to wholesale general insurance firms on "non-financial misconduct". It stated that how a firm handles non-financial misconduct - including discrimination, harassment, victimisation and bullying – is indicative of a firm's culture. It also noted that non-financial misconduct was an obstacle to creating an environment where it is safe to speak-up, where the best business choices are made and where the best risk decisions are taken. Interestingly, the FCA also remarked that it would consider any known relevant issues of non-financial misconduct when assessing the fitness and propriety of proposed senior managers.

The FCA made headlines in 2014 when it banned a managing director from taking up any senior role in the UK financial sector after he admitted evading his train fare on a number of occasions. The FCA stated that individuals who are approved to work within the financial services industry should conduct themselves with both honesty and integrity in both their professional and personal capacities.

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Although the CBI has not issued any correspondence concerning non-financial misconduct yet, it seems likely that this will also come under the spotlight, given several recent speeches which it has given on conduct and culture. In 2018 it established the Prudential Analysis and Inspections Division which provides technical expertise in the assessment of various risks, including "non-financial" risks.

**What to expect?**

The CBI's focus on conduct risk is here to stay, as strengthening its approach to conduct regulation is one of its strategic priorities for 2019-2021. Firms operating in both the retail and wholesale sectors need therefore to ensure that they are considering conduct risk in all its forms and that it is embedded in their organisational framework. A good place to start would be looking at the CBI's "A Guide to Consumer Protection Risk Assessment" and the "Dear CEO" letters referred to above.

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