



EBA Guidelines and FSA requirements for Managing Operational Risk in market related activities

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- What does BIPRU say
- Why were the guidelines drafted
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SYSC 4.1.1 R

A firm must have **robust governance arrangements**, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to **identify, manage, monitor and report the risks it is or might be exposed to**, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems.

SYSC 4.1.2R

These arrangements, processes and mechanisms must be comprehensive and **proportionate** to the nature, scale and complexity of the firm's activities.....

CP 11/9 – Consultation on BIPRU 6.1.1A

‘A firm that undertakes market-related activities should be able to **demonstrate to the FSA** that it has considered the Committee of European Banking Supervisors Guidelines on the management of operational risk in market related activities published in October 2010.

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- Response to rogue trading activities
- Can OR be taken seriously if we continue to see Rogue Trading
- 2 public consultations
- Implementation review by CEBS (the EBA)
- Questionnaire
- Gap analysis
- 17 principles but also underlying paragraphs

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- CEBS 216 - Past and recent cases show that when institutions do not adhere to basic principles of sound internal governance, the severity of operational risk events in market-related activities can be very high, **jeopardising** the institution's **earnings**, the existence of **the particular business area**, or even the existence of **the whole institution**.

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Governance mechanisms-

1. The management body should be **aware** of the operational risks, actual or potential, affecting market-related activities. It should develop and maintain an **organisational structure, internal controls and a reporting system** suitable for the **identification, assessment, control and monitoring of operational risks** in market-related activities.
2. The management body should promote, particularly in the front office, a **culture** designed to mitigate operational risks in market-related activities.
3. Senior management should ensure that they, and the staff in the control and support functions, have the **appropriate understanding, skill, authority and incentive** to provide an effective challenge to traders' activities.
4. Operational risk should be taken into account in setting **objectives** for, and in the assessment of, an individual's or business unit's performance in market-related activities.
5. **Proactive behaviour against actions** which are considered as **fraud or suspicious activities** in market-related activities should be a key element of internal controls and reporting systems.

Internal controls (1/2)-

6. Traders should initiate **transactions** only when these are **compliant** with their set terms of reference. Minimum standards for the initiation and conclusion of transactions should be followed.
7. **Documentation requirements** for trading activities should be properly **defined**. Legal uncertainties should be minimised so that the contracts are enforceable as far as possible.
8. As a general rule **transactions** should be initiated and concluded **in the trading room and during trading hours**.
9. All **relevant positions, cash flows and calculations** associated with a transaction (for example trading book positions, profits and losses and contingent cash flows) should be **clearly recorded** in the institution's IT systems with a documented audit trail.
10. Institutions should ensure that they have an appropriate framework of **controls over the relationships between traders and their market counterparts**.

Internal controls (2/2)-

11. Confirmation, settlement and reconciliation processes should be appropriately designed and properly executed.
12. Institutions should ensure that their margining processes are working properly and that any changes are reconciled with the relevant positions on their books.
13. Sources of operational risks in market-related activities should be properly identified and monitored with the appropriate level of scrutiny, intensity and timeliness.
14. The nominal value of transactions/positions should be kept under strict control for monitoring operational and counterparty risks through the definition of pertinent limits and/or participation in initiatives for the novation of contracts.
15. Information systems in the trading area should be appropriately designed, implemented and maintained so as to ensure a high level of protection in market-related activities.

Internal reporting system-

16. The operational risk **reporting system** for market-related activities should be designed to **generate appropriate warnings** and should **alert management** when suspicious operations or material incidents are detected.
17. Institutions should ensure the **quality and consistency of their internal reports** and that they are appropriate to the needs of the recipients for which they are intended.

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