



CEBS Guidelines for Managing Operational Risk in market related activities

Ensuring Compliance and Best Practice

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Introduction

avantage has developed an approach and tool to support assessment of the degree of compliance with the CEBS guidelines

- Functionality supports:
 - Assessment of management perception of compliance with principles
 - Assessment of management perception of compliance with implementation measures
 - Computation of assessment of compliance with principles based on assessment of compliance with implementation measures and compare to management's perception
 - Use as a repository of reference to evidence of compliance
 - Definition of a work plan to address gaps in compliance
- Bases of assessment:
 - Degree of sophistication
 - Degree to which embedded

Degree of Sophistication

- A notion referenced within the CEBS Guidelines that addresses consideration of the suitability of implemented measures with respect to governance mechanisms, internal controls and reporting systems relative to the market-related activities being assessed
- Paragraph 10 (CEBS Guidelines) notes the “**level of sophistication**” should take account of the principle of proportionality and be “commensurate with the complexity and magnitude of these activities within the individual institution”
- The advantage tool rates the 'level of sophistication' as follows:
 - Industry best practice (5)
 - More than appropriate (4)
 - Appropriate (3)
 - Less than appropriate (2)
 - Awareness / nothing in place (1)
 - Yet to be assessed (0)

Degree to which Embedded

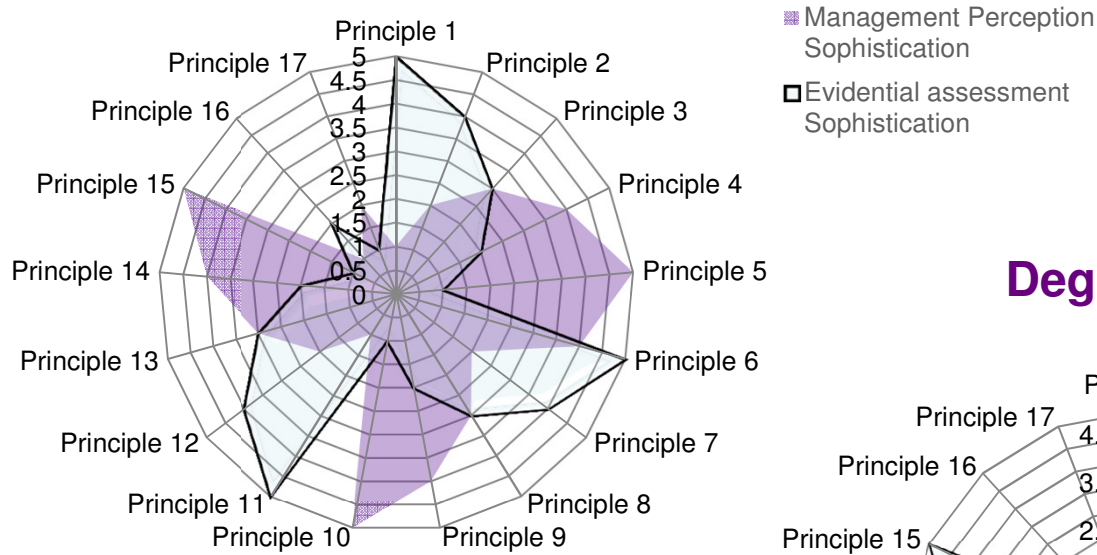
- A notion that addresses:
 - the breadth with which measures relating to governance mechanisms, internal controls and reporting systems have been implemented in relation to the market-related activity or activities being assessed, and
 - the depth with which they are integrated and used to monitor and control operational risks on a day-to-day basis and inform management decisions.
- The rating of degree to which embedded must consider BOTH breadth and depth of implementation. The rating must be commensurate with the weakest assessment of these two characteristics
- The avantage tool rates the 'degree to which embedded' as follows:
 - Comprehensive in scope and depth (5)
 - Significant in scope and depth (4)
 - Moderate in scope and depth (3)
 - Limited in scope and depth (2)
 - Awareness / not yet embedded (1)
 - Yet to be assessed (0)

Assessment Considerations

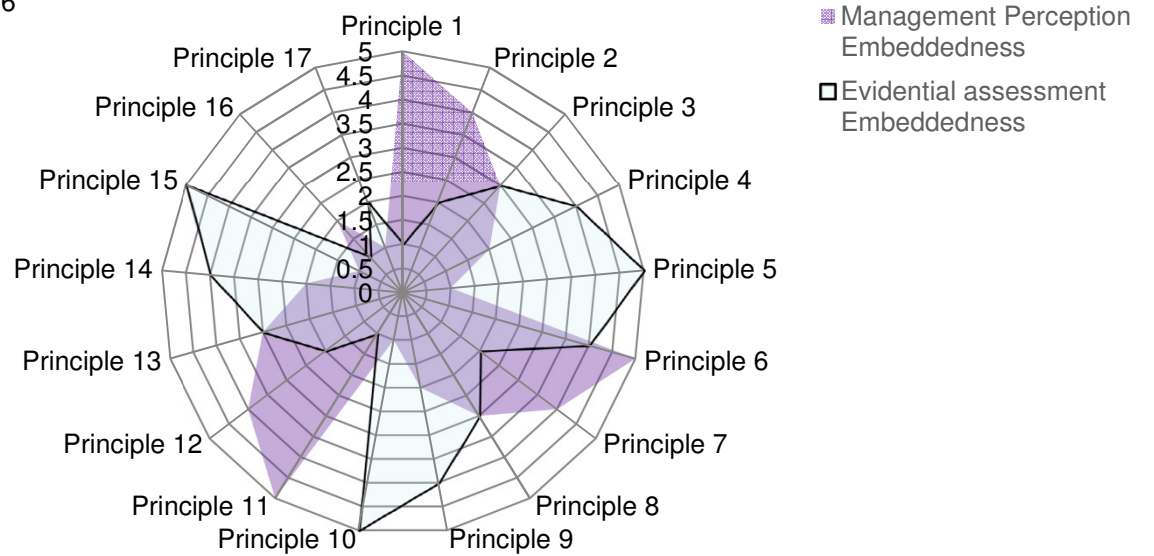
- **Scope** – assessment may be performed in relation to a single market related activity (e.g. product or business) or group of market related activities (e.g. multiple products or multiple businesses). In the latter case, assessment of the degree to which embedded must relate to all of the activities within the group under consideration
- **Diversity of Responsibility** – the scope of the Guidelines requires the assessment of measures that are typically represent responsibilities covered by a range of roles within the firm. One person may however be assigned responsibility for collating the assessment
- **Perception versus Practice** – management perception of degree of compliance and control can differ from the reality of practice within the line / firm. The avantage tool permits managerial perception to be assessed and compared to evidence of the degree of sophistication and to which embedded noted in practice

Example of Assessment Output

Degree of Sophistication



Degree to which Embedded



Conclusions

- Ensure that consideration of the principles can be evidenced.
- In assessing the principles, consider the degree of sophistication of the measures that your firm has in place and the degree to which they have been embedded within your firm
- Ensure that the principle of proportionality is taken into account in reaching your assessment of each principle
- Do not stop at the CEBS guidelines: expand your review as appropriate to the nature and scale of your firm's business activities. Set your own higher standards for measures that should be in place
- Ensure gaps are identified and addressed by action plans
- Re-review periodically or following material change

Insights to the Implementation of a Traded Markets control framework

A major international Investment Bank carried out internal Rogue Trader scenario analysis – The outcome lead to the decision to implement a Traded Markets control framework

- Outcomes of scenario analysis demonstrated that controls in market related activities were often below expectations
- Recommendations were to implement a control framework to enhance existing self certification process, aimed specifically at supervisors of trading and markets desks globally
- Initial lack of cooperation from Trading and Markets management of first line of defence
- Second line of defence attempted to construct control framework on their own – this was broadly unsuccessful due to the specialist nature of the business and the lack of engagement with markets management

Insights to the Implementation of a Traded Markets control framework

- Implementation required sponsorship from the most senior levels to get engagement from Traded Markets senior management
 - Once engaged the pendulum swung with very detailed analysis of the work developed by second line of defence
 - Much lengthy debate on describing the risks, controls, tests and evidence required to demonstrate acceptable levels of Traded Markets oversight
 - Many controls, tests and evidence were found to be difficult to define or agreed by senior management in some very specialist market activities
 - Efforts to identify and implement consistent key controls across diverse trading desks often floundered due to local variations in business practices (e.g. Europe vs. USA vs. Asia)

Insights to the Implementation of a Traded Markets control framework

- Key consideration was who can perform the tests and provide evidence
 - Testing personnel in first line did not initially exist
 - In some market activities testing staff needed to be at least as skilled as those participating in trading
- Issues
 - The quarterly testing regime was too onerous for Traders and Supervisors
 - The globally diverse trading desks in certain markets did not have the manpower to provide controls oversight or testing – in some instances this had to be done in trading hubs which was less than ideal
 - Controls defined for London market activities may have local variants defined by regulators in other Markets
 - Traders reluctance to adhere to controls e.g. ignoring them in fast moving markets and agreeing to surrender BlackBerrys etc. during leave periods
 - ‘Pass the book’ control solutions were rejected by some Trading Management

Insights to the Implementation of a Traded Markets control framework

- On-going developments
 - Move to half yearly trading controls certification to allow controls to be better defined and focus on improving controls rather than reporting
 - Hiring of dedicated testing staff and oversight specialists in First line of Defence
 - Attempts to find and use proxies for some controls to reduce the control overhead on traders, supervisors and testers. e.g.:
 - Information systems controls (e.g. access to Back/ Middle office systems)
 - HR controls (e.g. control of 10 days mandatory leave period)
 - Enhancement of First Line of Defence controls

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