



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Conduct Risk Assessment of Telephone and Electronic Communications

Industry Communication from the
Wholesale Market Conduct Function

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Conduct Risk Assessment of Telephone and Electronic Communications

Introduction

The Central Bank of Ireland (the **Central Bank**) recently undertook a Conduct Risk Assessment of Telephone and Electronic Communications (the **Assessment**) in firms engaged in securities markets activity. The conduct risk associated with unauthorised use of telephone and electronic communication devices is a key concern for the Central Bank. The Central Bank's Securities Markets Risk Outlook Report 2023 highlighted the risk of operating in a hybrid-working environment. It noted that:

“One concern with alternative working arrangements is the risk of market abuse related conduct risks arising from the use of unmonitored, unauthorised or unencrypted telephone and electronic communication devices.

Firms need to have policies, procedures, controls and a monitoring regime in place that has been adapted for hybrid working arrangements. In all cases, arrangements should be clear that new communication methods must be approved before being used by employee to conduct business activities.”

Maintenance of full and accurate records is important in order to show the intention behind trading. This information is necessary for the Central Bank to assess firms' compliance with market abuse requirements, conduct of business obligations, best execution, and order handling requirements. This information is also necessary to assist in the resolution of disputes between firms and their clients.

The Assessment examined the frameworks implemented by investment firms and credit institutions (**firms**), to ensure the use, recording and monitoring of firm authorised telephone and electronic communications is in compliance with the requirements set out in the Markets in Financial Instruments Directive¹ (**MiFID II**), specifically Article 16(7)².

This Industry Communication details the key findings identified during the Assessment. The Central Bank expects all firms to fully consider these findings and

¹ Directive 2014/65/EU.

² Paragraph 8 of Article 16(7) states that “an investment firm shall take all reasonable steps to prevent an employee or contractor from making, sending or receiving relevant telephone conversations and electronic communications on privately-owned equipment which the investment firm is unable to record or copy”.

evaluate their own frameworks for telephone and electronic communications. The Key Findings³, with associated Central Bank expectations, are outlined in the Appendix.

Summary of Findings

The Central Bank found that none of the firms included in the Assessment made amendments to telephone and electronic communications policies or procedures despite those firms moving from a largely in-office environment to an entirely remote or hybrid working model during and post the COVID-19 lockdowns.

Monitoring and testing conducted by firms did not meet the Central Bank's expectations. While the majority of firms conducted some form of monitoring of electronic communications, there was an absence of a systematic approach to monitoring telephone communications in some firms. In addition, the lexicons⁴ used by firms for electronic communications monitoring were ineffective.

Only a small number of breaches of policies and procedures were identified by firms, and this indicates that the firms' monitoring functionalities are not working effectively to identify potential breaches. Firms own disciplinary procedures were not followed in the majority of cases where breaches were identified.

Some firms did not have a clear policy or procedure in place in relation to the escalation of breaches. In addition, alerts generated through monitoring functionality, designed to highlight breaches, were closed without any rationale being attributed to the closure.

The Assessment identified that some firms exhibited good practices in ensuring that all telephone and electronic communications are recorded and retention periods are set in accordance with MiFID II requirements. It also found that many firms provide corporate devices to their employees as a mechanism to reduce the risk of communications being undertaken via unauthorised or unapproved channels. Furthermore, it is noted that all firms had the necessary IT infrastructure in place to ensure record keeping and recording of electronic communications.

It is the Central Bank's expectation that firms should continue to focus on driving continuous improvement in their frameworks regarding telephone and electronic communications.

This Industry Communication should be brought to the attention of all Board members, Senior Management and relevant staff as soon as possible but before the

³ The Key Findings are not exhaustive and firms should, at all times, evaluate their compliance with MiFID II requirements in relation to record keeping and recording of telephone and electronic communications.

⁴ Key words and phrases utilised in the detection and generation of system alerts.

end of Q4 2023. This is key in supporting effective identification, monitoring, reporting, and mitigation of wholesale market conduct risks, which may arise due to inadequate frameworks for the recording of telephone and electronic communications.

Appendix: Key Findings

Monitoring

Electronic and Telephone Communications Monitoring

The Central Bank observed that the lexicons used for electronic communication monitoring have not been appropriately calibrated, with firms heavily reliant on default system lexicon words and phrases.

The Central Bank, in analysing firms' electronic surveillance systems, observed a large volume of electronic communication alerts which had not been reviewed by some firms.

Many firms did not perform a formal quality assurance process on the alerts that had been closed. In other cases, a rationale for the closure of alerts was not provided.

Some firms did not conduct additional sample monitoring of electronic communications outside of those ingested into the relevant monitoring systems.

A number of firms used random sampling tests for the monitoring of telephone conversations. Other firms only reviewed telephone communications to ensure client instructions were processed as requested.

Expectation

In addition to on-going monitoring of telephone and electronic communications, the Central Bank expects firms to conduct sample testing of records to assess compliance with relevant aspects of MiFID II requirements. The sample size used for this additional testing should be commensurate with the nature, scale, and complexity of the firm.

The Central Bank expects firms to have the ability to reconstruct the audit trail of an order to execute a trade, through the recordings and records maintained.

Management Information on Electronic Communications Monitoring

The majority of firms included in the Assessment do not provide formal and regular management information to relevant senior management on the number of alerts, number of alerts flagged for review, or the number of alerts closed.

Expectation

The Central Bank expects senior management and the Board to be provided with regular management information relating to the record keeping, recording and monitoring of telephone and electronic communications. This should include information on the results of testing and sample testing, lexicon reviews, updates

to policies and procedures, breaches of policies and procedures and information on alerts generated through surveillance monitoring (e.g. number of open alerts, closed alerts, and alerts requiring further investigation).

Detection of Breaches

The Central Bank observed that the number of breaches which were identified by firms as part of their on-going communications surveillance monitoring was extremely low. This is an indication of deficiencies in firms' monitoring processes.

The details of breaches were not in all cases investigated by firms.

In addition, formal disciplinary action was not taken by firms where a breach was detected, with offenders only being issued with a policy reminder.

Expectation

The Central Bank is of the view that the low levels of breaches detected is a symptom of ineffective surveillance monitoring of telephone and electronic communications.

Where the firm does not identify any material breaches of policies or procedures through the monitoring and testing undertaken, or where a low number of breaches are identified, the methodology for undertaking the monitoring and testing should be evaluated by the firm to assess its effectiveness.

Firms should conduct a review of the lexicons used in their surveillance monitoring at least on an annual basis so that the firm can satisfy itself that the lexicons used are successful in identifying potential instances of the use of unapproved communication devices.

Employees who have breached the firm's Telephone and Electronic Communications policy should be dealt with through the firm's formal disciplinary procedure.

Controls and Controls Testing

All of the firms included in the Assessment permit the use of personal devices for the purposes of facilitating telephone and electronic communications. In addition, most firms provide corporate devices to their employees.

A minority of firms did not maintain a list of staff that have corporate devices and personal devices that have been approved for use by the firm.

60% of firms included in the Assessment conducted audits over the past five years which related to their arrangements to record, store, and monitor telephone and electronic communications.

Expectation

The Central Bank expects firms to conduct a periodic review of the approved communications list to confirm that it continues to be accurate and complete.

In the case that a firm does not record and monitor telephone or electronic communications for all roles within the organisation, the Central Bank expects firms to document in their policies and procedures the criteria used to determine whether certain roles are subject to communications surveillance.

Whilst not a legal requirement, the Central Bank is of the opinion that recording and monitoring of telephone and electronic communications pertaining to the execution of orders is an area that should be monitored more frequently in firms operating these business models, and internal audits should be conducted on a regular basis.

Policies, Procedures and Training

Some firms' telephone and electronic communications policies did not identify the telephone conversations and electronic communications subject to the recording requirements.

Other telephone and electronic communications policies did not specify the procedures to be followed and measures to be adopted where exceptional circumstances arise and the firm is unable to record the conversation/communication on devices issued, accepted, or permitted by the firm.

60% of the firms selected for this Assessment ensured that the Board reviews and approves recording of telephone and electronic communications policies and procedures.

60% of the firms selected for the Assessment provide training that covers the requirements pertaining to recording of telephone and electronic communications. However, in some cases, this training was not provided on a formalised basis and not all relevant staff of the firm received the training.

A good practice identified during the Assessment was the issuance of email reminders to employees setting out the permitted forms of communication. One firm also provided training on telephone and electronic communications, which addressed recent global regulatory actions in this area. Another firm circulated FAQs and hypothetical scenarios relating to the use of authorised communication devices to employees.

Expectation

At a minimum, the Central Banks expects the Board to have approved the firm's telephone and electronic communications policy.

The Central Bank expects formalised and specific training to be provided to all employees, at least on an annual basis.

Firms should consider issuing regular reminders to employees as to the importance of compliance with regulatory requirements. Visual reminders may be utilised such as signs in the office building, as well as the creation of mobile free areas, or reminders when using communications applications.

Recording and Record Keeping

All of the firms examined as part of the Assessment, retain records of telephone calls and electronic communications for a period of five years or more.

The majority of firms were able to evidence that appropriate controls are in place regarding the recording of communications made on authorised communication devices. These included:

- controls to ensure recording of phone lines is operational;
- access to recordings being restricted;
- duplicate recordings being maintained; and
- evidence that records could not be deleted or altered.

Expectation

The Central Bank expects firms to have procedures in place to ensure that relevant staff can only access telephone recordings for monitoring purposes or to fulfil other regulatory requirements. The access to such recordings should be reviewed on a frequent basis.

The Central Bank expects firms to continually assess new communication channels and functionalities being utilised by the firm or which may become downloadable on personal or corporate devices to ensure that all relevant telephone or electronic communications are being recorded in line with MiFID II requirements.

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