# FICC Markets Standards Board

## Front Office Supervision

Statement of Good Practice for FICC Market Participants

September 2017

# I Introduction

## 1. The FICC Markets Standards Board

The FICC Markets Standards Board ("FMSB") was established in 2015 in response to the Fair and Effective Markets Review in the UK with a mandate to issue Standards designed to improve conduct and raise standards in the wholesale Fixed Income, Commodity and Currency ("FICC") markets. The FMSB will work to build up a body of Standards and Statements of Good Practice ("SGP") over time, prioritising those areas where its Members consider there is a lack of clarity in the standards of behaviour expected of market participants, or a lack of understanding of the issues relevant to a product or transaction type, or evidence of poor conduct.

## 2. Applicability of FMSB Statements of Good Practice

FMSB SGP are issued by the FMSB from time to time. SGPs do not form part of the FMSB Standards and they are not subject to FMSB's adherence framework. Rather they reflect FMSB's view of what constitutes good or best practice in the areas covered by the SPG in question. FMSB members are expected, and other firms are invited, to consider their own practices in light of the SGP and make any changes to such practices that they deem to be appropriate. Failing to do so will not, however, create any presumption or implication that a firm has failed to meet its regulatory or other obligations.

Full details of FMSB Member firms are available at http://www.fmsb.com. SGP will be shared with Non-Member firms and their associations, who are encouraged to consider them. Information on SGP will be made available to users of the wholesale FICC markets (e.g. corporates and end investors) so that they may be made aware of their existence and FMSB expectation of market conduct.

The FMSB will as part of its normal course of business, periodically review the applicability of its published SGPs to ensure they are relevant and up to date for market conditions.

## 3. Relationship with law and regulation

FMSB Standards and SGPs do not impose legal or regulatory obligations on FMSB members, nor do they take the place of regulation. Rather they serve as a supplement to any and all applicable law, rules and regulation. In developing Standards and SGPs, relevant regulators will in many cases have commented on their drafting, alongside Member Firms and other bodies, such that the Standards and SGPs once finalized and published are intended to represent an authoritative statement of global good practices and processes.

## 4. Relationship with other Codes

Other Codes already exist in relation to certain FICC markets, such as the FX Global Code, whilst others are in the process of being produced. There will be some overlap between the work of the FMSB and such other bodies and the FMSB will seek to ensure it adopts a consistent approach in cases of overlap wherever possible, and will seek to avoid issuing a Standard or SGP where the subject matter is already covered adequately by existing regulation or a Code issued by another body. It may, however, draw attention to Member Firms of an existing Code and request adoption, once appropriate steps have been taken to confirm its applicability.

# II Front Office Supervision Statements of Good Practice

## 1. Background

The Fair and Effective Markets Review ("FEMR") was launched by the Chancellor of the Exchequer and the Governor of the Bank of England in June 2014 to reinforce confidence in the wholesale FICC markets in the wake of the serious misconduct seen in recent years; and to influence the international debate on trading practices. The FEMR Final Report published on 10 June 2015 set out a number of recommendations, which specifically stated that '… Firms active in FICC markets should take greater collective responsibility for developing and adhering to clear, widely understood and practical standards of market practice…'.

This paper has been developed by member firms of the FMSB to:

- Set out Good Practice Statements for front office supervision; and
- Make this information available to the industry.

Firms have responsibility for supporting fair and effective functioning of financial markets. Implementation of effective front office supervisory frameworks promotes the integrity and effectiveness of financial markets leading to better outcomes for all market participants.

Front office supervision is a fundamental first line of defence for firms when mitigating risks directly related to employee conduct and their business activities in the "FICC" markets. There are increasingly high expectations on firms to identify and correct poor conduct before it leads to potentially significant losses or negative impact on the effectiveness and efficiency of markets, including potentially negative outcomes for clients, other market participants or compromising effective competition.

Front office supervision is key to strengthening a firm's overall control framework in mitigating both financial and non-financial risks and promoting good employee conduct and culture. Regulatory interventions and remediation projects consequent to conduct failures are damaging in terms of loss of reputation and are costly and time-consuming. Those costs, as well as direct financial losses, may be avoided, or reduced, where misconduct can be identified and corrected earlier.

## 2. Scope and applicability

This document outlines SGP for the Supervision of front office activities that may directly affect the functioning of FICC markets and/or conduct with market participants.

FMSB expects each firm to consider their own practices in light of this SGP and consider the extent to which any changes might be appropriate.

FICC market firms are very diverse and therefore in considering the SGP firms should interpret them in light of their own circumstances, in particular their scale and complexity. This could include consideration of the extent to which a Supervisory framework might be documented or supported by IT infrastructure.

# III Good Practice Statements and Commentary

## 1. Organisation and responsibilities

***Good Practice Statement 1:*** Firms should clearly define activities that require supervision. This should include activities that directly impact the functioning of FICC markets.

Supervisors are those individuals who are responsible for the conduct of other employees undertaking activities defined as requiring supervision. Supervision is the activity of overseeing a process and/or individuals. A person who performs supervision is considered to be a supervisor for the purpose of these SGP even if they do not always have a formal title of a supervisor.

The concepts of supervision and supervisors referred to in these SGP should apply to a subset of individuals and activities in the front office (i.e. 'First Line of Defence'). These principles are not designed to address a wider context of generic employee supervision, or line management, across the whole organisation.

Supervision is one of the core tools in the first line of defence to ensure oversight of day to day business activities. Supervision consists of the oversight of activities and conduct including relevant preventative and detective controls. Typically, supervision is required for a subset of business staff whose activities could have direct adverse impact on fair and effective functioning of markets or fair and open market competition and for those who have mandates to take on primary business risks on behalf of their firms. Supervisors are responsible for overseeing the conduct of supervisees in undertaking these business activities and the extent to which they are adhering to the firm's own Code of Conduct or similar requirements.

Examples of front office roles subject to supervision include, but are not limited, to:

- sell side firms: traders, sales, research analysts, investment bankers, structurers, quants and developers in charge of trading strategies or trading systems, business personnel monitoring performance of trading algorithms (i.e. e-traders);
- buy-side firms: portfolio managers, traders, analysts, sales;
- infrastructure firms: personnel monitoring performance of trading platforms, quants and developers in charge of trading strategies or trading systems.

Business support functions, for example, operations or technology, as well as the second and third lines of defence are not covered within the scope of these SGPs, however, they may be required to provide support to supervisors.

***Good Practice Statement 2:*** Firms should ensure that responsibility for supervision remains with the appointed supervisors. Firms should have in place clear arrangements setting out if and how supervisors can delegate certain tasks to others.

Supervisors may delegate specific tasks to others, provided they ensure that this process is sufficiently independent from the supervisees and is subject to procedural controls ensuring completeness, accuracy and integrity of output. While supervisors can delegate specific tasks and preparation of the relevant data to others, firms should ensure that responsibility for supervision remains within the appointed supervisors.

Supervisors may rely on a wide range of information provided by support or control functions in discharging their supervisory duties. Firms should define sets of information prepared by other functions and output from other controls (e.g. surveillance or compliance escalations) that supervisors should receive and use in discharging their responsibilities.

When the quality of data or inputs from other functions does not meet the expectations of Supervisors, they are expected to initiate appropriate action by the relevant function to resolve and/or to escalate the risk to senior management if required in accordance with internal escalation policies.

***Good Practice Statement 3:*** Firms should ensure they are comfortable with the level of competence and experience of supervisors. Supervisors should have sufficient knowledge, experience and understanding of the business to be able to discharge their supervisory responsibilities.

Firms should consider sufficient knowledge and experience requirements for supervisors. Furthermore, the level of knowledge and experience to be expected of supervisors will vary depending on the activity being supervised (see Good Practice Statement 6 for factors that may be considered).

Firms could consider the following attributes when setting their requirements:

- the nature and extent of prior relevant experience;
- experience of specific markets and/or client sectors;
- corporate grade (e.g. director, vice president);
- role (e.g. head of a desk, lead portfolio analyst);
- any relevant local registration requirement applicable to the location where supervision will occur; and
- any local regulatory requirement which may be applicable.

Firms should carry out internal assessments when appointing supervisors as well as ongoing assessments of their performance in the role. These assessments should take into account input from the regular employee performance assessment cycle and any conduct or risk issues. When hiring external candidates into a supervisory role, the assessment against the minimum criteria should be part of the selection process.

Firms should provide supervisors with suitable training to ensure they understand their roles and responsibilities and have sufficient knowledge to perform their duties.

Supervisors should take reasonable steps to understand risks involved in their business and the risk appetite of the organisation.

***Good Practice Statement 4:*** Firms should have in place general escalation procedures. These procedures should support the effective escalation by supervisors, or supervisees, including any circumstances in which individuals have concerns with the ability for supervisory responsibilities to be fully discharged.

Firms should establish frameworks for the escalation and resolution of concerns relating to effective supervision. Firms should ensure that supervisors and supervisees are aware of the escalation framework.

When supervisors are concerned with their ability to discharge effective supervision, they are responsible for following the escalation procedures. Supervisors should understand the outcome of their escalation and where relevant they should initiate appropriate action by the relevant function to resolve the problem.

## 2. Supervisory hierarchy

***Good Practice Statement 5:*** Firms should have a defined control framework to demonstrate that they maintain complete supervisory coverage of all relevant employees and activities over time.

Firms should maintain accurate records of activities in scope for supervision and of their supervisory hierarchy. For example, trading businesses could use a complete population of trading books and ensure that every book is assigned to an owner and each owner has a supervisor. The extent of the records maintained should be proportionate to the extent and complexity of the activities in scope for supervision.

Firms should have in place controls to ensure the completeness of their supervisory coverage over time. This should include controls over:

- individual new joiners, movers and leavers;
- initiation of new business which may include new markets, products, trading venues, or client sectors;
- changes in the internal business hierarchy;
- changes to internal policies; and

- implementation of requirements due to changes in regulation.

Firms should ensure that their supervisory hierarchy covers all relevant supervisors up to heads of businesses or entities. Firms should have transition and handover procedures in place to ensure continuity of supervision, for example in case of new joiners, movers, leavers and changes to or setting up of new businesses.

***Good Practice Statement 6:*** Firms should define the reasonable span of supervision for individuals to ensure that supervisors are able to effectively discharge their duties. The span of each supervisor's supervisory duty should be reasonable and supervisors should have sufficient time and capacity to perform their supervisory duties.

The span of supervision refers to the number of individuals and range of activities that an individual supervisor oversees. Firms should consider what the reasonable span of supervision is for their business to ensure that supervisors can be effective in their role. Some examples of factors to consider in defining the reasonable span are set out below:

- number of employees supervised;
- number of supervisors supervised (i.e. this could be applicable to more senior supervisors in the hierarchy);
- number of books, portfolios or desks supervised;
- size and complexity of the business activity supervised;
- ease of use of supervisory tools;
- the extent of time-zone and geographical coverage;
- experience of supervisors; and
- seniority of individuals supervised.

Supervisors should be able to identify and escalate situations in which the span of supervision may be unreasonable, including due to any of the factors listed above. This can be supported by effective training on the matter and firms should consider whether periodic review and agreement on the span of supervision is required.

***Good Practice Statement 7:*** Firms should put arrangements in place to ensure that it is clear and unambiguous to all employees who their supervisor is, and to all supervisors, who they supervise. Where an individual has more than one supervisor, firms should clearly set out how multiple reporting lines are applied, and define the scope and the responsibilities of each supervisor.

Firms should maintain a clear record and evidence of their supervisory hierarchy. These records should be in such a form as to enable firms to check who in the past had supervisory responsibilities for a given person, for example, when responding to regulatory requests or performing internal look back reviews.

Firms should consider making current mappings available internally within their organisations to all employees.

There may be occasions when an employee has more than one supervisor. In such scenarios, the split of responsibilities between supervisors should be clearly defined and a process should be in place to ensure complete coverage of all in scope activities by supervisors in accordance with Good Practice Statement 5.

***Good Practice Statement 8:*** Firms should maintain supervisory delegation arrangements which ensure that, in line with the other principles set out in this SGP, delegates are in place when supervisors are not able to discharge their duties, for example, due to holidays, business travel, other absence or circumstances preventing them from effectively performing their supervisory duties.

Firms should have arrangements in place to maintain pre-determined delegates for each supervisor.

In case of an unplanned absence of a supervisor, it should be clear who the delegate supervisor is, in line with Good Practice Statement 7.

Identified delegates should be able to satisfy the requirements of Good Practice Statement 3 on knowledge and experience. Firms should consider whether in certain circumstances, for example when delegating ‘downwards’, additional arrangements, such as monitoring or controls, need to be put in place to support effective supervision by delegates.

Firms should assess whether conflicts of interest may be created or exacerbated by the selection of delegates. For example, situations should be avoided whereby a delegate is being asked to temporarily supervise parts of their own activity (for example, as may occur in ‘downwards’ delegation), or to supervise businesses or activity with clients that may have conflicting objectives to their own (for example, as may occur in ‘horizontal’ delegation).

Firms should put in place arrangements for handovers to and from delegates in relation to planned absences. The format of these handovers can vary depending on the complexity of the business and the anticipated length of absence. Firms should consider whether the handovers should be evidenced.

## 3. Location of supervisors

***Good Practice Statement 9:*** Where supervision from a different location is appropriate, firms should define and implement any specific additional arrangements required to support effective supervision.

There are valid circumstances under which supervision from a location different to a supervisee is necessary and appropriate. These circumstances may include, for example:

- Firms with several offices that manage risk in a single trading book via remote bookings
- The operation of small offices with management oversight provided remotely

Local supervision (i.e. in the same office and, in the context of a trading business, within physical proximity on a trading floor) may have benefits over supervision from a different location due to the proximity of the supervisor to supervisees. However, supervision from a different location may be preferable when considered in light of other Statements of this SGP, for example, Good Practice Statement 3 on knowledge and experience, and with global processes (see Good Practice Statement 10). When implementing supervision from different locations, firms should consider all other relevant Good Practice Statements, such as those on clarity and completeness.

There should be a clear split of responsibilities between supervisors in different locations and any local supervisors, and all activities in scope should be assigned to supervisors. Firms should develop a framework and provide guidelines to ensure complete and effective assignment of responsibilities to supervisors, when a supervisory arrangement involves remote supervision.

There are scenarios, for example when trading risk is managed in a central book, where overall supervision arrangements can be effective when split between central supervision of market risk and a local supervision over behaviour of traders and sales personnel.

Supervisors in different locations should have adequate means and arrangements in place to support them in discharging their responsibilities and should be given the means to escalate situations in which concerns arise about the adequacy of those arrangements. Regular interaction with supervisees and periodic site visits should be considered as part of effective supervision.

***Good Practice Statement 10:*** Firms should establish a clear supervisory framework over global processes (e.g. global books, trading platforms operating across multiple locations, global portfolios). Global processes may result in certain risks being centralised in the hub for the activity, and other risks remaining in the respective locations of staff operating the global process. This split should be considered when allocating responsibility for supervising staff operating global processes.

Global processes may be active across multiple locations at the same time and multiple time zones over the day. Example of global processes include, but are not limited to, the following:

- global trading books operating a follow the sun model, such as FX trading books
- funds or portfolios comprising of stock in multiple locations managed from different time zones, such as ETFs based on global indices which trade stocks in several countries
- trading platforms and trading algorithms running in multiple time zones and locations

Firms should ensure that every global process has appropriate Supervision in place for the entire process.

## 4. Control environment

***Good Practice Statement 11:*** Firms should ensure that their supervisory framework gives adequate consideration to the frequency of required supervisory controls which should be based on the nature and risks of the supervised activities.

Certain activities and risks occur, or are best supervised, on a daily basis. For example, books tend to be formally re-marked once a day to update official records and for limit monitoring purposes, and reporting of operational fails may be produced overnight to be reviewed the next day.

Other activities are more suited to intra-day oversight. For example, trading activity may require more frequent Supervision of conduct in the immediate vicinity of significant market events.

Similarly, the conduct of sales and trading staff when interacting with counterparties and selling to customers is an activity that requires qualitative oversight. Whilst there should not be a need for supervisors to continuously monitor staff, the approach to supervision, and tools available to supervisors, should reflect how risks may arise.

***Good Practice Statement 12:*** Firms should provide their supervisors with sufficient tools and information to enable them to carry out their supervisory duties and supervisors should satisfy themselves that they have the right tools and data to discharge their duties.

Firms should ensure that tools and information provided to supervisors are designed to take into account the specific nature, complexity and risks of supervised businesses. Supervisory tools and information should allow supervisors to gain sufficient understanding of their supervisees' activities so that supervisors can exercise effective professional judgment and can assess relevant risks, conduct and behaviours of their supervisees.

Given different risk profiles of buy-side, sell-side and infrastructure firms as well as a large diversity of business models and activities within these groups, there is a wide range of types of information which may be relevant to supervisors. Firms should assess what information will sufficiently support their supervisors in the context of their specific businesses and associated risks.

***Good Practice Statement 13:*** Firms should establish minimum standards and arrangements for retaining evidence to demonstrate operating effectiveness of their supervisory controls.

Supervisory controls should be designed, implemented and operated in a way which makes them auditable by independent reviewers, including the firm's own internal audit function.

Firms may wish to consider putting supervisory systems in place where all relevant information, alerts and supervisory sign-offs and escalations are documented and tracked. These supervisory systems can include a workflow to track and evidence supervisory escalations or exceptions through to resolution.

***Good Practice Statement 14:*** Firms should have an established framework to monitor the effectiveness of their supervisors and supervisory arrangements, including in relation to the Good Practice Statements contained within this SGP.

Firms should have in place controls to monitor effectiveness of supervision. Examples of the potential relevant controls include, but are not limited to:

- setting up supervisory platforms which track daily sign-offs and relevant supervisory reviews,
- periodic evaluation of supervisors carried out by audit or a similar function who selects a sample of supervisors to perform a deep dive assessment of how effectively they performed their role over time

## IV. Emerging practices

The Good Practice Statements set out in these SGP represent FMSB's view of good market practices. At the time of publication, it is understood that many firms are in the process of implementing and embedding principles similar to those set out in the SGP into their normal operating models. Firms are also focusing on improving sustainability of supervision operating models and achieving long term efficiency of their supervisory frameworks through better use of technology, data and simpler or more automated processes.