

SHCOG

Meeting 17 March 2022

Challenges of Surveillance

1. Operating Model for Surveillance

- Panellists describe how their program is structured
- Split between 1L, 2L or 1.5L
- Emphasise that there is no right/wrong answer and that program needs to be appropriate/proportionate to your business model.
- Regulators look for independence from the Business

2. Data – the importance of data

- The quality of data is a key part in ensuring the effectiveness of your program. Therefore a robust quality control framework around the program is needed. Regulators not just looking at the number of controls you have in place.
- Some firms will use an internal storage of order and trade records, a drop-copy (a record of all a firm's activity) from the trading venue or a combination of both, as inputs to surveillance controls.
- FCA Market Watch 68, highlighted where gaps can appear with these records e.g. web based GUIs and storage of unexecuted order flow.
- Examples seen of data issues with drop-copy data from venues include:
 - venues not portraying immediate or cancel orders correctly in the flow that requires specific remediation such as synthetically creating the order enter.
 - electronic quotes that interact with central limit order book not being included in the order data.
 - product information being poor e.g. all strikes of same maturity and product grouped into same ID.
 - ensuring drop copies are set up correctly to capture all flow and not a sub-set.
- Solutions are the quality control framework and using your own internal order records to supplement the drop copy data, working with trading venues to improve the drop copy data or working with surveillance vendors to improve the handling.

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3. Regulation, Governance and Oversight

- Market Abuse risk assessment is one of the key documents that regulators will expect to see when examining your program. Firms should ensure that this is updated at least annually, whenever risks change or new product lines from the Business.
- FCA continues to have a focus on fixed income surveillance.
- Surveillance programs are often a target for regulators, auditors or auditors on behalf of regulators. Having strong governance and oversight framework is essential, especially when being audited 12-18 months after a decision was taken e.g. approach to COVID in March 2020.
- FCA have just published their 2021 STOR figures and firms could use this to benchmark their program.

4. Education and Staff Retention

- Retaining talent is a challenge. Good quality staff need to be kept challenged and see progression otherwise you are more likely to lose them.
- Regular training programs for analysts is essential, particularly on local nuances if surveillance teams are based in near-shore/off-shore locations.
- Good analysts should be focussed for any market abuse and not just that of a specific control e.g. a wash trading alert at end of day should also have the analyst considering potential marking the close angle and not just the wash trade element.
- If working with surveillance vendors, you should assume a lack of knowledge around market microstructure, business flows and potential market abuse to get the best outcome from discussions.

5. Evolving Business Environment

- As business changes e.g. new product lines, new venues/algos/trade flows, constantly need to ensure there is a framework in place for surveillance implications to be considered.
- COVID (March 2020) acted as a reminder for firms to consider operational resiliency, impact on tuning and calibration. The Russia/Ukraine situation has seen the latest test of adjustments made since March 2020.

6. Machine Learning

- How are firms using machine learning ? Seems to be more on the Comms side of the program e.g. natural language processing rather than trade surveillance.
- Is there a role for machine learning based on closure codes of trade surveillance alerts? Concern here may be the small volumes of true positives on which a model could accurately learn from.