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# Dear Ceo Letter To Principal Trading Firms (PTFs)


## Clare Curtis, November 2023


The Financial Conduct Authority (FCA) has sent a general letter to all CEOs of PTFs detailing what the regulator regards as the most important risks within the firms and what it views as the drivers of those risks. In addition, it informs us of what their expectations are of the PTFs and what FCA's supervisory focus will be over the coming two years in relation to these firms.

## Scope

The boards of PTFs will be expected to discuss the points set out, take note of what applies to their business framework and take appropriate action where necessary. The issues are not just aimed at bond and equity market makers but also those trading in commodities, derivatives, emission allowances and so forth, including, and this is essential, algorithmic trading, which can be extremely high frequency and in turn can carry high risks. The FCA realise how critical a role PTFs play in trading both in the UK and across the globe. They provide both liquidity and formation of prices and are very often pioneers in technological developments in financial markets, helping in the supply of benefits to investors by reducing expenses and increasing trading speeds. But of course, all of this comes with significant levels of risk if not overseen and managed correctly.

## Background

Recent years have proven to be very trying on financial markets with issues such as the Russian invasion of Ukraine, Covid, the cyber-attack on ION markets, and several other geopolitical challenges. Hence, there is ever increasing pressure on the management of trading systems to avoid any harm to investors and financial markets. Operational Resilience and cyber-security have never been as vital as they are now or will be moving forward.

Although the FCA have noted that overall, firms have proved to be somewhat resilient throughout, the regulator remains on high alert, as they have also seen instances where some firms are not adequately familiar with their requirements and appear to have flaws in their governance and controls within their infrastructure. Of course, as well as concerns with PTF's internal frameworks the FCA have also identified the possibility of issues in relation to third-party suppliers.

Market abuse is an intrinsic driver of harm among all PTFs, where, if controls and sub-standard market abuse policies, as well as poor top-level management, are not addressed, there is the potential that levels of market manipulation and disruption could increase. Additionally, those that employ algorithmic trading strategies, pose an even greater risk of harm if not governed sufficiently.

As such, the FCA have identified five key areas where they will apply their focus for their PTF supervisory strategy, these are:

### 1. Algorithmic Trading Controls

Algorithmic trading is a prominent part of financial markets but, as previously mentioned, it comes with inherent risks, resulting in it being essential that firms' controls, governance, oversight functions, compliance and risk-management continue to adapt to the exponential complexity and pace of financial markets and advances in technology. The regulator deems it critical that firms regard the market conduct implications of their trading activity and what impact it may have on market integrity. They anticipate firms to employ at least sufficient resources in maintaining effective oversight functions and controls in order to minimise the harmful effects of any trading incidents on the orderly functioning of the markets they participate in. Additionally, firms are expected to be able to demonstrate that the systems and controls they utilise are bespoke to the nature, size, and complexity of their business models. The regulator has stressed, as it has on many occasions, that it will hold senior management responsible for their firms' activities and any lack of controls.

**2. Financial Resilience**

It is vital that firms have sufficient financial resources in order to effect, if necessary, an orderly wind down so as not to harm investors and/or markets, ensuring they have healthy plans ready to meet potential demands on both capital and liquidity.

Now that the new Investment Firms Prudential Regime (IFPR), is in place, the FCA intend to exercise targeted reviews of firms' capital and liquidity, taking action where necessary if they discover any inadequacies including the possibility of business restrictions.

The FCA want firms to expand the scope of their stress testing to incorporate greater stress testing with more severe but plausible scenarios than previously used.

**3. Avoiding market disruption arising from commodity market volatility**

Commodity trading is an area the FCA seem to be particularly focused on due to recent extreme market volatility. Several firms have encountered credit stress, increased trading costs and shortfalls in capital, due to episodes of market stress in energy, metals and government bonds markets. The regulator noted that some firms have had insufficient governance which has resulted in failures to manage their resources accordingly. As a result, the FCA have administered intensified monitoring and engagement with market participants to try to mitigate problems to the wider financial system.

They have suggested that they will continue to do so and remain alert as to new issues and developments and adjust their approach accordingly, including where relevant, to clearing firms.

**4. Operational Resilience**

Aware that technology plays a vital role in PTFs business models, the FCA expect PTFs to ensure they have embedded the guidelines in their Operational Resilience policy statement, and that they are sure they can operate within their impact tolerances as soon as possible and definitely no later than 31/03/2025. The regulator will be reviewing firms' implementation schemes and expect them to be able to evidence that their approach involves wider resilience requirements into a coherent overall framework.

**5. Brexit Impacts**

Having noted how the UKs exit from the European Union has had an impact on firms from different angles and to differing degrees, the FCA anticipate firms that entered into the Temporary Permissions Regime (TPR) to investigate as to whether their activities in the UK will require them to apply for full permissions, and other firms to consider any restructuring requirements or indeed alterations to business models, including movement of staff, entity, trading desk or function.

The FCA are aware that several firms have employed new structures for the execution and booking of transactions, plus their risk management and oversight. On occasions, these changes involve different entities across different jurisdictions, potentially adding to new complexity and risk. In these instances, the regulator wants firms to reserve sufficient control over their regulated activities in the UK and ensure that they can be supervised effectively at all times.

Any firms who become subject to the FCAs requirements for the first time can expect the regulator to be in touch and will focus on the above issues as well as several other factors including the Senior Manager and Certification Regime.

## Conclusion

The FCA conclude by telling every CEO that they are responsible for relevant staff in their firm to understand the FCA rules and principles and ensure that they are complied with at all times. They expect all CEOS to have discussed the letter with their boards and to have any actions to be taken agreed upon.

## How can Effecta help?

If you are within scope of this Dear CEO letter and require any guidance as to its impact please do reach out to Effecta. Our consultants can assist you in understanding what changes need to be made within your firm to ensure compliance with the FCA's expectations. Specifically Effecta can review your firms governance arrangements, Brexit structure as well as assist in any enhancements required to your ICARA.

**To contact Effecta, click here**