

Front Office Control Framework

In these days of increased regulatory scrutiny over the asset management industry, with all the protections around customer outcomes, market infrastructure, and conduct of investment staff, is it any wonder that firms are turning their attention to risks and controls within their front office operations? Whether this is driven by ICARA (Internal Capital Adequacy and Risk Assessment), SMCR (Senior Managers and Certification Regime), any other impending regulation, or just an Asset Management firm striving for greater operational control and risk management, Front Office Control Frameworks are an increasingly important topic in the industry. It is also a topic where the perception is that the sell-side would appear to be far ahead of the buy-side, so perhaps there is an element of “catching-up” going on...

If there is any single area of an asset management business where there is the highest potential for detriment to the client to occur, then surely it is within the front office. Common processes such as ensuring best execution (one process amongst many) are fraught with potential pitfalls which represent risks to providing the best possible customer outcomes. Depending on the asset type, the liquidity of the asset, how orders might be aggregated, and many other factors, what (on the surface), might seem a simple concept becomes a minefield to negotiate. Understanding the potential fail points, the risks, and the monitoring/controls required to mitigate for anything being sub-optimal has never been more important than it is now. So how can asset management firms ensure that they are on top of their game, and keep the regulatory hounds at bay?

Having a well-considered, properly defined, and robust Front Office Control Framework in place is now just as fundamental a requirement as having a license to conduct asset management business. So, what does a robust Front Office Control Framework look like?

The first thing to say is what it is not.... It is not a disparate set of papers each covering an individual process, authored by different people at different times to different standards, and filed away so that in the event that something goes wrong, someone can pull out the relevant page and point their finger and say “You didn’t follow what it said on page 23, section 4b”

The control framework needs to be a tool that is actively used by the business to identify all the potential risks and fail-points within front office operations, and to pro-actively monitor those activities carried out by the business, identifying potential issues as soon as they arise. Key components include:-

- An inventory of each process
- Variations within each process (e.g. for different asset characteristics)
- Risks associated with each variation for each process
- Monitoring required for each variation within each process
- A clear set of accountabilities for the doing and monitoring of each process
- Controls for each risk (pre/during/post)
- Remediation activities in the event of a failure

- Documentation of the control framework
- Governance model over the framework with defined roles and responsibilities (and traceability thereof)

Bear in mind too that this will be an ever-changing framework, which will need to be reviewed and properly updated as required for new regulation, previously unidentified risks, or as the business diversifies.

Key questions around the responsibilities for the framework also have to be considered: Who builds it? Who monitors it? Who takes actions based upon any findings? Is there a new and distinct business function associated with it, or does it fall within the remit of your existing 1st and 2nd lines of defence, and if so, how should it be split?

Ideally, perhaps the control framework will ultimately be a proprietary system in itself, in the form of a “framework administration tool” capable of monitoring that all controls have been applied, when, who by, and with integrated workflow, back-end management reporting, and alerts for red flags. This may be a stretch too far for firms at this time, but in a few years-time, this might just be what regulators start to demand as they seek to protect customers still further.

Please get in touch with us should you wish to discuss how ISC Ltd can help you – reg-change@iscLtd.com