

ESMA Consultation Paper – guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities

Q 1: Do you agree with ESMA that it is appropriate to introduce guidelines already before the review of MiFID covering organisational arrangements for trading platforms and investment firms in relation to highly automated trading, including the provision of DMA/SA?

The guidelines will clarify obligations in relation to a highly automated trading environment for trading platforms. Most of the obligations already exist under the legislative framework and should be considered as best practice so the guidelines can be conducted without prior legislative changes. ESMA expects to adopt final guidelines at the end of 2011. However if once adopted there should be an appropriate transition period in which the specifications could be amended or revised by trading platforms together with their market participants. Since both MiFID and MAD are currently under review the guidelines need to be adapted to the revised version of the framework and directive. Thereof the risk arise that the specifications of the trading platform have to be adapted again in a short timeframe to reflect the upcoming regulatory changes with the risk of additional costs.

Therefore we strongly recommend ESMA to consider carefully the need of such guidelines at this stage. Furthermore the guidelines will provide greater clarity but also will include material changes with additional tasks and duties; under risk – benefit analysis we see currently no such importance of the issues raised by automated trading.

In our view e.g. co-location services as well as tick sizes regimes play an important role in a highly automated trading environment. These topics and the issues ESMA identified in its CP should be dealt with together with the micro-structural issues under the revised MiFID and MAD.

Finally and despite the fact that MTFs and RMs provide the same business MTFs seems to be less regulated especially in the field of market surveillance. The draft guidelines would reinforce the differences rather than aligning it.

Q 2: Do you think that the draft guidelines adequately capture all the relevant points relating to the operation of the trading platforms' electronic trading systems

From our point of view the guidelines cover all the relevant points. In addition to the implementation of guidelines we furthermore support to implement requirements that are currently obligatory for all credit institutions. In particular we support an obligatory annual examination performed by external auditors which already is an established process for credit institutions. The scope of examination of external auditors should be extended (e.g. on a periodic basis, e.g. in the annual audit) on the content of the guidelines in order to check the compliance with the guidelines.

The external auditor shall analyse adequate risk management, the outsourcing organisation, the prohibition of market abuse and fraud and the internal audit function.

The external auditor shall review the key issues Governance, Resilience, Testing, Staff, Review, Records etc. mentioned in the Consultation Paper.

The analysis shall be risk based and pay particular attention to the system relevance of the venue. The results of the analysis shall be reported to the relevant supervisory authority.

Q 3: Are there areas where it would be helpful to have more detail on the organizational requirements applying to trading platforms' electronic trading systems?

We have no further additions.

Q 4: Do you have additional comments on the draft guidelines on organisational requirements for trading platforms' electronic trading systems.

We have no further additions.

Q 8: Do the draft guidelines on organizational requirements for trading platforms to promote fair and orderly trading offer a sufficiently comprehensive list of the necessary controls on order entry?

Members should have in place systems and controls such as assessing volume and price as well as the number of orders to avoid erroneous orders sent to the platform. Such controls would enhance the quality of the price discovery process.

Limiting the number of orders a member is allowed to send to a trading venue restrains them from reacting to special market situations or to external influences. This is also true for measures aimed at the restriction of price and volume of an order to a predefined range.

Q 9: Are there any areas of the draft guidelines on organizational requirements for trading platforms to promote fair and orderly trading where you believe it would be helpful to have more detail?

Guideline 3 mandates trading venues to stipulate that they may cancel, amend, or correct a transaction. Where such authority is already provided, the constant discussion arises on why an individual trade was cancelled, amended, or corrected. The parameters to resolve that question vary widely. ESMA should therefore consider establishing a set of parameters to be applied Europe-wide.

Q 10: Do you have additional comments on the draft guidelines on organizational requirements for trading platforms to promote fair and orderly trading?

It is the intention to promote fair and orderly trading. To achieve this, Guideline 3 intermingles different aspects that should be separated: 1. Admission to Membership; 2. Order entry activity and 3. the trading mechanism.

1. Membership Admission

Regulated Markets and MTF's have to ensure that only Members participate in trading who are fit and proper. This does include the organizational structure of members, their technical readiness to interact with the particular trading system, as well as their ability to ensure settlements of transactions. Regarding the organizational structure, MiFID and the related regulations implemented

a regime of requirements for Credit Institutions and Investment Firms which Regulated Markets and MTF'S rely on. MiFID is not applicable to certain institutions that may nevertheless be a member to a regulated market or a MTF as they are engaged in trading of financial instruments. As these institutions are not within the scope of application of MiFID, ESMA expects the trading venues to close that loophole.

If Members of a trading venue are expected to comply with organizational requirements based on those in MiFID, the legislative authority should extend the scope of application of MiFID. Further, even if regulated markets and MTF's implemented such requirements, otherwise unregulated institutions would freely trade in OTC markets.

2. Order entry

Restrictions on order entry have already been commented in Question 8.

3. Trading mechanism

The trading platform should have built up systems and controls to ensure an orderly price discovery process and to prevent abnormal upward or downward spirals. Therefore, trading venues already have volatility interruptions in place. These are highly sophisticated and well implemented. ESMA therefore should not concentrate on mandating trading venues to implement the described additional safeguards.

Q 14: Are there any areas of the draft guidelines on organisational requirements for trading platforms to promote fair and orderly trading where you believe it would be helpful to have more detail?

Transaction reporting under MiFID enables supervisors to monitor the activities of investment firms and ensure compliance with MiFID, and to monitor for abuses under the MAD. RMs and MTFs may currently allow access to persons who are not authorized as investment firms under MiFID and which are currently not subject to transaction reporting obligations but however in scope of the market abuse provisions. This situation can impair the quality of market monitoring and supervision. Therefore the transaction reporting obligation should be extended to capture HFTs as well. The organizational requirements subject to their adoption should take this into consideration.

MAD will also likely be extended to cover attempted market abuse. This extension creates the need for consolidated and comparable order information. The consolidated information should be available on a European level. There should be in place harmonized technical standards to enable market monitoring and supervision on a European level.

Bearing in mind that a financial instrument can be traded on a number of different platforms the exchange of information should be better coordinated in order to better detect market abuse or misconduct that takes place across different venues. The exchange of information preferable submitted in real time should therefore also include information provided from the operator of the RM and the MTF to their respective domestic supervisory authorities who then should consolidate this information on a National and European level.

However all the matters above should be dealt with in accordance with the revised MAD which is currently under review (see answer Q15). This is because the exact relationship between trading platforms and competent authorities in relation to dealing with market abuse varies across jurisdictions.

Q 15: Do you have additional comments on the draft guidelines on organisational requirements for trading platforms to promote fair and orderly trading?

EMSA suggests RMs and MTFs should have effective arrangements and procedures in place which enable them to identify conduct by their members/participants and users that may involve market abuse in a highly automated trading environment. In our view the proposal does not take into account the international environment of the trading landscape in Europe and the market supervision which has to be conducted on an European level in a highly automated trading as well the risk of high costs resulting from the amendments. This is because the position of the individual trading platform to detect market abuse is limited to what is happening in its own order books.

Therefore we recommend that the issues identified by EMSA should be dealt with in the revised MAD. This is in line with the European Commission view in its Public Consultation released 8 December 2010 where it is stated that *"... there have been concerns raised by some market participants that specific algorithmic trading strategies may be contrary to the MAD*. While the majority of algorithmic trading strategies do not involve abusive behaviour, specific strategies (such as layering and spoofing) could breach the Market Abuse Directive and have been subject to guidance issued by supervisors. However there seems no consistent practice conducted by authorities. Therefore the European Commission considers that further improvements could be introduced in MAD notably by better defining conduct or practices by means of automated trading that may constitute market abuse.

Furthermore the proposed draft guidelines would reinforce the differences in the requirements that apply to MTFs and RMs which is diametrical to the European Commission's view to further align the organizational requirements for MTFs with those for RM so both operating similar business are subject to equivalent organizational standards and regulatory oversight.

Finally MAD currently does not cover attempted market abuse. As attempted market abuse is not limited to transactions but also extends to orders to trade, we can't see any appropriate reason why the systems currently used by the market surveillance already should be enhanced in advance.

Q 18: Do the draft guidelines on organizational requirements for trading platforms whose members/participants or users offer DMA/SA deal adequately with the differences between DMA and SA?

The draft guidelines define DMA and SA in a comprehensible and differentiated manner. However the issue should be dealt with between the trading firms and the regulator.

To avoid any future discussion about responsibility for client orders, the rules of the trading venue should state that the DMA/ SA provider remains fully responsible for all orders entered using his trading ID.

Q 19: Are there any areas of the draft guidelines on organizational requirements for trading platforms whose members/participants or users offer DMA/SA where you believe it would be helpful to have more detail?

We have no further additions.

Q20: Do you have additional comments on the draft guidelines relating to organizational requirements for trading platforms whose members/participants or users provide DMA/SA?

Common understanding among the trading industry places the responsibility for all orders entered by using DMA/ SA on the DMA/ SA provider.

The risks associated with DMA/ SA either 1. jeopardize the service provider or 2. interfere with the trading venue.

1. DMA/ SA provider

Trading risk, credit risk and reputational risk are the risks of the DMA/ SA provider. Rather than mandating the trading venues with regulating the internal controls of DMA/ SA providers, these services should be considered Investment services or activities or Ancillary services and fall into the scope of a revised MiFID.

2. Trading venue

The risks of market-wide disruption and market abuse are not idiosyncratic to DMA/ SA. Whether a disruptive order is entered through DMA/ SA or directly does not influence its deleterious effect.

Nevertheless, trading venues should be allowed to refuse a request from a member for individual clients, withdraw a granted access or stop orders from individual clients while accepting other orders from the member sponsoring the clients' access.

The trading platform should have in place rules which require the DMA / SA provider that orders sent by its client using DMA / SA access should be marked.