

FESE Response to ESMA Consultation Paper systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities – ESMA/2011/224

1. Introduction

The Federation of European Securities Exchanges (FESE) represents 46 exchanges active in equities, bonds, derivatives and commodities through 21 full members from 30 countries, as well as 7 observer members from European emerging markets. FESE is a keen defender of cross-border competition and many of its members have become multi-jurisdictional exchanges, providing market access across multiple investor communities. FESE members operate Regulated Markets (RMs), which provide both institutional and retail investors with transparent and neutral price-formation. In line with the interests of the broader market, securities admitted to trading on our markets have to comply with stringent initial and ongoing disclosure requirements and accounting and auditing standards imposed by EU laws.

FESE members are happy to contribute to ESMA's consultation. FESE supports efficient, fair, orderly and transparent financial markets that meet the needs of well protected and informed investors and provide a source for companies where to raise capital. In Europe, capital markets have greatly changed since the implementation of the Markets in Financial Instruments Directive (MiFID). This has resulted in more competition among trading venues as new types of them (Multilateral Trading Facilities, MTFs, and Systematic Internalisers, SIs) now compete with one another. Competition facilitates greater efficiency and pushes technological innovation. FESE members support both global and European wide competition on a level playing field as a means of achieving the most significant efficiency and reductions in trading costs.

Significant technology advancements have been implemented by trading venues, in a bid to provide the investor with improved access to and interaction with the market. One of them is high frequency trading (HFT), which allows more accurate, granular and faster pricing of securities. Following the US Flash Crash – the roots of which are, for various reasons, specific to the US – the focus has shifted to HFT and the potentially detrimental effects it may have on already volatile markets. It is important to note that HFT makes a positive contribution to market quality; nonetheless, it is also vital to deal with the concerns surrounding HFT activity and its effect on market safety and integrity. Recent research conducted on the subject of HFT and market efficiency found that, to date, there is no direct evidence that HFT trading has increased volatility¹. In this regard, FESE welcomes this opportunity to outline the provisions taken by its members to foresee potential problems and the tools that they have put in place to safeguard against them.

2. General Remarks

In addition to our responses to the different questions outlined below, and in an equally constructive spirit, we would like to note the following observations we have about this consultation in general that go beyond specific issues:

i. HFT definition and provisions for market integrity

FESE agrees with the view that HFT is not a strategy in itself, but a sub-set of automated trading and encompasses many different trading strategies. In this regard, FESE agrees with the provision for

¹ 'The Future of Computer Trading in Financial Markets': Please see: <http://bis.gov.uk/assets/bispartners/foresight/docs/computer-trading/11-1276-the-future-of-computer-trading-in-financial-markets.pdf>

enhanced organisational requirements to safeguard the efficient and functioning integrity of the markets indicated by the European Commission.

ii. Limited scope of the consultation

FESE has understood that the purpose of ESMA's work is to provide an immediate set of guidelines that can be implemented with the current MiFID Directive. However, there are other areas on which ESMA could also consult and issue guidelines that could be introduced under the existing framework.

Such a vital issue would be HFT rules for the operation of trading platforms under the OTC license. We believe that ESMA could use its guideline powers to consult and rectify this issue. As ESMA states, '*the Review will take some time and urgent issues should be addressed within the existing framework at least as much as possible*'. In fact, without this set of guidelines, the current guidelines will be inadequate, as any quantity of HFT happening on OTC platforms, and therefore are not labelled as Regulated Markets or MTFs, would fall outside the scope of the current consultation paper. In this context, we believe that all venues operating either with a Systematic Internalisation license or as OTC should be covered.

It is proposed that the guidelines in this consultation paper are to be imposed on trading platforms and investment firms. The guidelines are very different depending on which group you are in, which makes sense if every trading venue is classified as a trading venue. However, the consultation only refers to Regulated Markets (RMs) and MTFs as trading platforms. We consider this focus to be too narrow. There is the question as to why 'trading platforms' does not also include Systematic Internalisers (SIs), which according to MiFID 1 are regulated trading venues. Moreover, MiFID does not include any definition of a 'trading platform', only a 'trading venue' or 'execution venue'. By definition SIs are doing systematic trading and are subject to various trading venue rules. Indeed, some brokers could potentially use their SI licence to interact with HFT as well to expand to trading venues and execution venues.

Much of the current policy debate on HFT is focused on the lit markets and, when it refers to dark venues tends, to focus on regulated dark trading venues. Less considered is the issue of interaction of HFT in the OTC space. By contrast, some recent researchers have suggested that HFT exists in the OTC space, probably in particular in the platforms known as Broker Crossing Networks (BCNs) in Europe which are currently regulated as OTC. Whether the HFT trading in the OTC space has the same trading strategies as in RMs or MTFs may not yet be known (due to the limited public information about OTC trading in Europe); however, it is known that the proprietary desks of the crossing system providers often act as market makers applying strategies that are largely comparable to HFT market making on lit markets. As a result, according to one study², '[a]ny assessment of HFT based strategies has to take a functional rather than an institutional approach. HFT is applied by different groups of market players from investment banks to specialized boutiques. Any regulatory approach focusing on specialized players alone risks (i) to undermine a level playing field and (ii) exclude a relevant part of HFT strategies.' We support this recommendation.

Moreover, the exclusive focus of this consultation is on trading platforms and investment firms when acting as routers of orders to other platforms. This consultation does not examine the HFT firms themselves or investment firms acting as HFT. The focus of the consultation appears to place the responsibility on the trading platforms and the investment firms routing orders and not on the HFT firms overall. This is also linked to the next issue (iii).

² Peter Gomber (2011) 'High Frequency Trading'. Please see : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1858626

iii. Responsibility

FESE believes that it is essential that any proposed guidelines contain no ambiguity on what entity with which the eventual responsibility rests. There needs to be a clear and well defined division of labour in order for market participants to understand their role in ensuring a fair and orderly market. An example of such a need for a clear distinction of responsibility is the issue of Direct Market Access (DMA) and Sponsored Access (SA). It must be made clear that due to the nature of the business, it is the intermediary offering either DMA or SA that must bear the ultimate responsibility for orders sent to the trading platforms.

iv. Level of flexibility

ESMA must ensure that it achieves the right balance between the correct level of details contained in the guidelines and the need for flexibility in how trading venues are allowed to execute these guidelines. This flexibility must be based on the business model and the financial instrument being traded. FESE believes that an excessive level of detail would hinder trading platforms ensuring a fair and orderly market and fulfilling their functions correctly.

v. Access to trading platforms

These guidelines must take into account that different trading venues facilitate different investor profiles. Therefore, they may desire to be more restrictive to firms using algorithmic trading strategies accessing their platforms. In principle this should be allowed.

3. Response to Consultation Questions

3.1. Organisational requirements for trading platforms and investment firms in a highly automated trading environment

Q1: 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?

FESE agrees with and supports ESMA's work in proposing guidelines on this issue. However, FESE believes that any attempt to introduce guidelines must be – to the extent practicable – coherent with the current thinking and direction of the European Commission's proposal on the MiFID Review.

Furthermore, FESE believes that these guidelines would be further strengthened if their scope was broadened to include firms through which investment firms can connect to a trading system (i.e. connectivity service providers). It is likely that some of the duties ascribed to investment firms by virtue of these guidelines can realistically only be carried out by the service provider, if such a relationship exists. Investment firms would face a prohibitive cost were they to attempt to discharge these duties, and if the service provider lacks a regulatory obligation to adopt these responsibilities, there is a risk that they may not be voluntarily adopted.

3.2. Draft guidelines on electronic trading systems for trading platforms and investment firms

a) Trading platforms

Q2: Do you think that the draft guidelines adequately capture all the relevant points relating to the operation of trading platforms' electronic trading systems?

These draft guidelines as proposed by ESMA indeed cover the main areas of governance, resilience, testing, staff, review, records and co-operation with competent authorities.

Specific comments on these aspects as outlined in the proposed guidelines are included below:

i. Business Continuity Plans

FESE believes that any Business Continuity policy should identify potential risks and threats to the organisation. In moments of crisis, the Business Continuity policy will help to prevent operational interruptions and allow the organisation to quickly return to a state of 'business as usual'.

In order to be effective, the Business Continuity policy should be designed according to the following steps:

- o Business impact analysis: Identification of critical operations and services, key internal and external dependencies and appropriate resilience levels and assessment of the risks and potential impact of various disruption scenarios on an organisation's operations and reputation.
- o Prevention strategy: Identification and implementation of measures which can be put in place to proactively prevent operational interruptions taking place, and to prevent crises and disasters occurring.
- o Recovery strategy: Clear specification of objectives and priorities in the event of a disruption. The recovery strategy should establish the roles and allocate responsibilities for managing operational disruptions and provide clear guidance regarding the succession of authority in the event of a disruption that disables key personnel. It should also set out the decision-making authority and define the triggers for invoking the organisation's business continuity plan. It should establish targets for the level of service the organisation would seek to deliver in the event of a disruption and the framework for ultimately resuming business operations.

ii. Stress testing of systems:

As outlined in the FESE response to the European Commission's MiFID consultation, many Regulated Markets in Europe already conduct stress tests of their systems. The purpose of these tests is to ensure that their systems are equipped to deal with a large sudden influx of orders on their markets. It may be beneficial of ESMA to compile a list of the current testing already in place in European markets.

Each market is subject to its own peculiarities and therefore there does not appear to be the scope for a one-size-fits-all approach to this.

iii. Staffing

Regulated Markets already employ a number of staff to manage their electronic trading systems. ESMA would need to ensure that all new trading platforms established since the introduction of MiFID have taken similar steps as RMs in this regard.

iv. Platforms that do not operate their own trading system

FESE believes that more regard should be given to Regulated Markets (RMs) and Multilateral Trading Facilities (MTFs) which do not operate their own electronic trading system. The guidelines appear to place onerous duties on trading platforms that would be impossible for platforms to carry out if they outsource the operation of their system. Certain RMs and MTFs are in a position where they rely on the provider of their electronic trading system to perform many of the tasks that are listed in this section. Perhaps the guidelines intended to cover this situation should be made clearer and state that a trading platform using the electronic trading system of another can be allowed to outsource its development, testing and other duties where relevant and governed by the business relationship, and indeed contractual agreement between a trading platform and its system provider. We believe that the platform should be able to rely on the fact that the system provider is carrying out these tasks by virtue of the terms and conditions of the contract.

In this regard we suggest the opening line would state: "In following the general guideline regulated markets and multilateral trading facilities should, **by themselves or, where relevant, under the terms of the agreement with its trading system provider**, at least..."

Q3: Are there areas where it would be helpful to have more detail on the organizational requirements applying to trading platforms' electronic trading systems?

Stricter controls on conflicts of interest on all trading venues and execution venues should be put in place in order to prevent unlevel playing field.

Q4: Do you have additional comments on the draft guidelines on organisational requirements for trading platforms' electronic trading systems?

FESE agrees that platforms should have appropriate capacity limits for volumes. However, FESE does not believe that it is realistic to introduce guidelines on absolute figures that cap the level of trading.. FESE believes that the best approach is to have equivalent requirements based on the trading activity happening on a venue by venue basis but equal on all trading venues.

Moreover, trading venues are not in a position to fully divulge the details of how they may slow or control order flow when needed. While it is true that intermediaries need a certain level of predictability of execution, there is always the risk that the knowledge of the exact method of how order volumes are controlled may cause some market participants to use this information to distort the market.

b) Investment firms

Q5: Do you think that the draft guidelines adequately capture all the relevant points related to the operation of trading algorithms?

These draft guidelines as proposed by ESMA indeed cover the main areas of governance, resilience, testing, staff, review, records and co-operation with competent authorities. Comments on these aspects as outlined in the proposed guidelines are included below:

i. Appropriate Risk Management

FESE believes it is critical that risk management must take place at the source of the order flow. The right approach is to ensure that this does not take place at the level of the trading venue, but at the level of the investment firm in order to ensure that all risk is properly captured and managed. This is due to the fact that in many cases the trading venue is unable to do each aspect of effective risk management.

Current legislation does not oblige HFT firms to register as investment firms; however, following indications from the European Commission on the upcoming MiFID proposal, FESE supports this registration as investment firms. This will see HFT firms adhere to greater rules and obligations that will ensure better market integrity.

ii. Testing & Risk Controls

Concerning testing, it is important that no unnecessary restrictions are placed on liquidity provision. Regardless of how much testing is conducted, there will always be an element of risk involved with the implementation of a trading algorithm. However, in such cases where a so-called ‘rogue algo’ becomes present, RMs have certain risk controls, such as circuit breakers, in order to prevent an extreme volatility as has happened during the US Flash Crash. In order to ensure the safest possible markets, we agree that these algorithms only be used in markets where they have been tested.

It is not necessary to regulate stress testing of trading venues as other aspects of regulation and competitive pressure together ensures that trading venues provide the necessary investments into their infrastructure and ensure infrastructures remain robust.

RMs usually offer, and in some case mandate, testing for new entrants to their venues or when existing members have to adapt or change technology to connect and communicate with the venue. As changes to algorithms may not affect such communication, the algo trading firms must ensure their systems and controls are adequate and fulfil the rules of the venues they are accessing. Such interaction on a voluntary basis should be accommodated wherever possible. In any case, this should not be mandatory but left to the market operators.

Q6: Are there areas where it would be helpful to have more detail in the guidelines applying to the organisational requirements for investment firms’ electronic trading systems?
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In order to ensure the correct level of risk management and to avoid tackling the breaches of an electronic system only after they have occurred, it is vital to have an effective system of pre-trade risk controls in operation.

Therefore, in order to reduce systemic risk, we believe the following risk management elements are necessary for investment firms:

- **Pre-Trade Controls** – controls in place prior to submission of orders to trading platforms;
- **At-Trade Controls** – controls in place immediately after submission of orders to trading platforms;
- **Post-Trade Controls** – controls in place after submission of orders to trading platforms later in time than at-trade controls;
- **Real-Time Enterprise Awareness** – real-time awareness at a market participant enterprise level of each client’s trading activity across all asset classes, trading systems and trading platforms for which the market participant bears financial and/or regulatory responsibility; and
- **Real-Time Flow Control** – ability to exercise real-time control over a client’s flow on a pre-, at- and/or post-trade basis, as appropriate in order to comply with financial / regulatory obligations, based on enterprise awareness of their trading activity.

Q7: Do you have additional comments on the draft guidelines relating to organisational requirements for investment firms' electronic trading systems?

3.3. Organisational requirements for trading platforms and investment firms to promote fair and orderly markets in a highly automated trading environment

a) Trading platforms

Q8: Do the draft guidelines on organisational requirements for trading platforms to promote fair and orderly trading offer a sufficiently comprehensive list of the necessary controls on order entry?

i. Controls

FESE agrees that ultimately it is for members/participants and users of trading platforms to ensure that they do not make errors in order entry. FESE notes that in the explanatory notes on this guideline there is a reference to 'erroneous orders' that trading venues must attempt to cancel before they are entered into the order book. This would be possible for systems that automatically cancel orders that deviate too far from the given spread; however, it is more difficult to cancel orders that appear to erroneous due to their size or the speed at which they are entered. We do not think that these cancellations would result in a fairer or more orderly trading environment as such a system may in fact reject 'good' orders in case of extreme volatility and significant price movement. We believe that the circuit breakers and trading halt mechanisms are sufficient and more effective in this regard. Ultimately, the responsibility must lie with the intermediary entering the orders.

These guidelines could be more effective if they regulated message activity and did not limit some of the conditions to order entry only. One definition of message activity includes order entry but also modifications and deletions which we believe should also be included as they also impact the capacity of systems. In particular, that the rule in relation to avoiding excessive flooding would be better achieved if it referred to message entry and not order entry. In turn, a reduced limit of messages per second could be put in place when there is a danger that capacity limits might be reached.

ii. Market Access

Despite the controls that a trading venue may put in place, trading venues are not in an adequate position to sufficiently screen any individual's access to the trading venue via an intermediary who is a registered trading member. Any guideline that obliges trading venues to ensure that a trader has the right to trade a given financial instrument is too cumbersome if they are not a direct member of the platform.

FESE agrees that regulators should look at the issue of naked sponsored access in order to ensure that the correct level of responsibility is adhered to by intermediaries. Until this issue has been solved, FESE is against naked sponsored access.

FESE believes that ultimately the onus of responsibility still lies with those who allow access.

iii. Testing

As previously stated in this response, RMs usually offer, and in some case mandate, testing for new entrants to their venues or when existing members have to adapt or change technology to connect and communicate with the venue. As changes to algorithms may not affect such communication, the algo trading firm must ensure its systems and controls are adequate and fulfil the rules of the venue it is

accessing. Such interaction on a voluntary basis should be accommodated wherever possible. In any case, this should not be mandatory but left to the market operators.

iv. Circuit breakers

A large portion of existing RMs and MTFs already have circuit breakers in place. As these control mechanisms are already in place, we do not feel the need to mandate venues to use them. RMs and MTFs understand that in order to ensure investor confidence and an efficient market place, a well functioning control system is vital, especially in the wake of the US Flash Crash. Controls should not be harmonised across trading venues, as this would cause difficulties and a “one-size-fits-all” approach may not be appropriate for all products and circumstances. Instead each venue should be allowed to implement the trading controls that best suits its market and operating system.

Please see below the table summarising the current risk controls in place in some trading venues:

Name of trading venue(s)	Type of trading venues		Circuit Breakers		Stress Testing	
	RM	MTF	RM	MTF	RM	MTF
Athens Stock Exchange (ATHEX-ASE) operated by Athens Exchange S.A	Yes	Yes	YES	No	Yes	No
Bolsas y Mercados Españoles	Yes	Yes	Yes	Yes	Yes	Yes
Börse Berlin Equiduct	Yes	Yes	Yes	Yes	Yes	Yes
Bulgarian Stock Exchange	Yes	-	No	-	No	-
Budapest Stock Exchange	Yes	-	Yes	-	No	-
Cyprus Stock Exchange	Yes	Yes	No	No	No	No
Deutsche Boerse: ▪ Frankfurter Wertpapierbörse ▪ Eurex Deutschland	Yes	Yes	Yes	Yes	Yes	Yes
Irish Stock Exchange	Yes	Yes	Yes	Yes	Yes	Yes
Istanbul Stock Exchange	Yes	-	Yes	-	Yes	-
Istanbul SE: Automated Trading System (OTASS) [in the Bonds and Bills Market]	Yes	-	No	-	No	-
Ljubljana Stock Exchange –Trading on Xetra® System (Xetra® backend Vienna)	Yes	-	Yes	-	No	-
Luxembourg Stock Exchange Euro MTF	Yes	Yes	Yes	Yes	Yes	Yes
Malta Stock Exchange	Yes	-	Yes	-	No	-
NASDAQ OMX: ▪ NASDAQ OMX Nordic ▪ First North	Yes	Yes	Yes	Yes	Yes	Yes
NYSE Euronext ▪ Cash Markets ▪ Derivatives Markets	Yes Yes	Yes N/A	Yes No	Yes N/A	Yes Yes	Yes N/A
Oslo Børs: Oslo Axess, Oslo ABM, Oslo Connect	Yes	Yes	Yes	No	No	No
SIX Swiss Exchange	Yes	-	Yes	-	YES	-
Warsaw Stock Exchange	Yes	-	Yes	-	No	-
Wiener Boerse: Xetra Vienna	Yes	Yes	Yes	Yes	No	No

Q9: 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?

These guidelines refer to the ability of RMs and MTFs to cancel, amend or correct transactions but lack any further information on the permissible time periods and authorisation requirements. This is too broad in its coverage and we believe that the cancellation of trades is the most transparent approach to facilitate a fair and orderly trading environment. We are concerned that amendments and corrections could lack transparency and potentially result in misleading information. Furthermore, we do not believe that the ability to amend lends itself well to order book trading. With the built-in controls and highly automated method of matching, we are unsure how trade amendments could be handled in an efficient manner. Furthermore, we consider that the ability to cancel (and potentially amend or correct) should only be possible on the same day of the trade. We think it would be inappropriate and potentially misleading to allow a longer period, which would also possibly create difficulties for efficient clearing and settlement of trades.

Furthermore, while MiFID is likely to create harmonised trade flags for cancelled and amended trades, there is currently no scope for creating a correction trade flag. In order to ensure consistency across different types of trading, we do not believe it would be appropriate to introduce a trade correction message for order book trading.

Q10: Do you have additional comments on the draft guidelines on organisational requirements for trading platforms to promote fair and orderly trading?

FESE believes that the guidelines concerning standardised testing and IT compatibility should be in the guidelines for investment firms only, and not for trading platforms.

b) Investment firms

Q11: Do the draft guidelines on organisational requirements for investment firms to promote fair and orderly trading offer a sufficiently comprehensive list of the necessary controls on order entry?

FESE agrees that there is a need for robust pre- and post-trade controls and adequate risk management in order to ensure that investment firms fulfil their regulatory obligations under MiFID and MAD. Investment firms should ensure that the systems that they are using to access the venue have a minimum level of functionality that is compatible with fair and orderly trading on the venue

Q12: Are there any areas of the draft guidelines on organisational requirements for investment firms to promote fair and orderly trading where you believe it would be helpful to have more detail?

Q13: Do you have additional comments on the draft guidelines on organisational requirements for investment firms to promote fair and orderly trading?

3.4. Draft guidelines on organisational requirements for trading platforms and investment firms to prevent market manipulation in a highly automated trading environment

a) Trading platforms

Q14. Are there any areas of the draft guidelines for trading platforms on organisational requirements for regulated markets and MTFs to prevent market manipulation where it would be useful to have extra detail?

It is essential that any monitoring system that may be put in place in a trading venue is specific and tailored to the size and business of that venue. FESE does not support a one-size-fits-all approach to this.

It is important to note that trading venues are not in a position to flag which trades were executed via DMA. In order to ensure an audit trail to detect potential market abuse, it is more appropriate for investment firms offering DMA to keep a record of which trades were executed in either manner. Investment firms must also be obliged to submit to a trading venue the individuals that are using DMA before they commence trading.

Q15. Do you have additional comments on the draft guidelines on organisational requirements for RMs and MTFs to prevent market manipulation?

We have a concern over the level of detail contained in the explanatory note on this guideline. These notes highlight certain trading activities that may be considered abusive; however, there is no explanation as to why they can be considered to be abusive. Therefore, we believe that they should not be included in any explanatory note that accompanies these guidelines. This level of detail is too great and may lead to incoherent interpretation.

It is important to highlight the need to make a difference between HFT (a legitimate activity supported by technology) and the conduct involving abusive or fraudulent trading strategies or behaviours. HFT is not abusive by nature and is subject to all current MAD requirements.

b) Investment firms

Q16: Are there any areas of the draft guidelines on organisational requirements to deal with market manipulation for investment firms where you believe it would be helpful to have more detail?

Q17: Do you have additional comments on the draft guidelines relating to organisational requirements to deal with market manipulation for investment firms?

FESE believes that paragraph 3 of the proposed guideline should be extended by the following text (*in italics*):

3. Investment firms should keep adequate records of the arrangements and procedures to identify conduct that may involve market abuse covering the matters in paragraph 2. *‘They should be able to deliver supervisory authorities with necessary data for investigation and back testing options, when required (including the recording of all input and output parameters to be able to reconstruct the behaviour of the systems).’*

IV.2. Organisational requirements for direct market access and sponsored access

a) Trading platforms

Q18: Do the draft guidelines on organisational requirements for trading platforms whose members/participants or users offer DMA/SA deal adequately with the differences between DMA and SA?

These draft guidelines as proposed by ESMA appear to deal adequately with the differences between DMA and SA.

Specific comments on these aspects as outlined in the proposed guidelines are included below:

i. Control Over Sponsored Access

FESE agrees that ultimately the DMA/SA provider firm remains responsible for all trades using their market participant ID code. In this regard, those third parties seeking SA must first be approved by the sponsoring firm before applying for a unique ID code from the trading platform. This ID code would be a subset of the code assigned to the trading firm.

Q19: Are there any areas of the draft guidelines on organisational requirements for trading platforms whose members/participants or users offer DMA/SA where you believe it would be helpful to have more detail?

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

We believe that it is important to clearly differentiate between the concepts of Direct Market Access and Sponsored Access. In each case, the controls shall be tailored specifically, depending on the type of access concerned. For instance, it should be tailored in the case of Direct Market Access because the trading venue does not have control over this activity since a customer's DMA flow first passes through the relevant member broker's systems (and is therefore already subject to financial and regulatory controls and checks of its own). Moreover, the member broker remains financially responsible for business conduct in this way. Contrary to the suggestion in the ESMA Guidelines, it is therefore, not necessary for the market operator to pre-approve the use of DMA by each individual member broker.

b) Investment firms

Q21: Do the draft guidelines on organisational requirements for investment firms providing DMA/SA deal adequately with the differences between DMA and SA?

These guidelines appear to adequately deal with the differences between DMA and SA. However, these guidelines must ensure that adequate pre-trade risk management is in place in order to ensure that the firm complies with its obligations under MiFID and MAD.

Q22: Are there any areas of the draft guidelines on organisational requirements for investment firms providing DMA/SA where you believe it would be helpful to have more detail?

Q23: Do you believe that there is sufficient consistency between the draft guidelines on organisational requirements for investment firms providing DMA/SA and the SEC's Rule 15c3-5 to provide an effective framework for tackling relevant risks in cross border activity and without imposing excessive costs on groups active in both the EEA and the US?

FESE believes that ESMA must maintain the view expressed by the SEC in Rule 15c3-5 that, although they believe that market centre-provided pre-trade risk controls can be useful risk management tools, they continue to believe that broker-dealers with market access should be responsible in the first instance for establishing and maintaining appropriate risk management controls under the Rule.

We consider the ESMA guidelines should take into account this view.

Q24: Do you have additional comments on the draft guidelines on organisational requirements for investment firms providing DMA/SA?

Q25: Does the explanatory text provided in addition to the guidelines (see Annex VII to this CP) help market participants to better understand the purpose and meaning of the guidelines? Should it therefore be retained in the final set of guidelines?

There is a concern about the role that these explanatory notes will play as these guidelines are implemented by different member states. There is a risk that these explanatory notes will provide too much detail and therefore will lead to incoherent implementation across member states. Any proposed guidelines should provide in themselves the explanations of their purpose. Having said this, any additional explanations that can be provided to help market participants better understand the guidelines are welcomed, as long as they are concise and exhaustive.