

**ESMA Consultation paper**  
***Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities***

**Bank of America Merrill Lynch ('BofAML') Response dated 3 October 2011**

Bank of America is one of the world's largest financial institutions, serving individual consumers, small and middle-market businesses and large corporations with a full range of banking, investing, asset management and other financial and risk-management products and services. Following the merger with Merrill Lynch on 1 January 2009, Bank of America Merrill Lynch became the largest brokerage in the world and now serves clients and customers in more than 100 countries.

The company is a long-established participant in the European markets, with a presence since 1922. The company employs over 15,000 people in Europe, the Middle East and Africa (EMEA), and has offices in Bahrain, Belgium, France, Germany, Greece, Ireland, Israel, Italy, Lebanon, Luxembourg, Monaco, the Netherlands, Russia, Saudi Arabia, South Africa, Spain, Switzerland, Turkey and the United Kingdom.

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**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?**

Subject to the guidelines being consistent between this ESMA initiative and the wider regulatory reform initiatives such as the MiFID review and the Market Abuse Directive, we are supportive of ESMA's efforts. We note, however, the following issues:

- As written, the consultation paper (CP) contains areas where guidelines are expressed only in broad, generic terms, and it is not until such guidelines are described in more specific and detailed terms that we can opine on consistency and appropriateness of approach;
- The CP appears to provide guidelines for all financial asset classes; given the differing market models, trading structures, and electronic components involved in support of the trading of various asset classes, we view this as a very difficult objective to achieve. We firmly believe that significant attention needs to be paid to establishing an appropriately differentiated and flexible set of guidelines per asset class to reflect the differences in market structure per asset class and their relative degree of electronic automation in the various components of the trading process;
- We seek clarity throughout the CP on the intended scope of each rule, specifically concerning the difference between providing electronic access to markets and trading platforms on behalf of clients (who themselves may have regulatory responsibilities relevant to the guidelines) and using our electronic trading capability for our own purposes as an investment firm;

- Finally, the MiFID Review introduces the concept of Organised Trading Facility (OTF), effectively to capture all organised trading activity that currently exists outside a Regulated Market (RM), Multilateral Trading Facility (MTF) or Systematic Internaliser (SI) regime. Throughout this CP, where guidelines refer to "trading platforms", "regulated markets" and "multilateral trading facilities" we assume that they do not also refer to OTFs and SIs – and we would seek further clarity on how ESMA plans to update the guidelines to reflect such changes in the MiFID Review. Similarly, we seek further clarity on how ESMA will update the guidelines to reflect changes in the new Market Abuse Directive. We are supportive of clarifying the regulatory responsibilities of each person in the execution chain (client, investment firm, trading platform) so that each entity is held accountable and responsible from a regulatory perspective for its actions, for example, in relation to market abusive activities.

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

Materially, we believe that the guidelines capture all relevant points although we do not believe they contain sufficient clarity, both in terms of the guidelines and scope of applicability by asset class and/or market structure. We also refer back to our general comments in answer to Q1, which apply here.

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

We would seek flexibility and appropriate and clear delineation on the applicability of the guidelines to the various electronic processes supporting the trading of the various asset classes.

The following guideline specified in paragraph 4 -- "Regulated markets and multilateral trading facilities should inform competent authorities about significant incidents that may affect the sound management of the technical operations of the system." -- is vague and broad. Further clarity on what constitutes a "significant incident", and the method, format and timing requirements of reports to competent authorities should be provided.

We also refer back to our general comments in answer to Q1, which apply here.

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

We do not have further comments specifically on this section, though we refer back to the general caveats made in response to Q1 which apply here.

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

With reference to the issues we flag in response to Q1, we are concerned about the broad application of these guidelines across all asset classes. Specifically, we would

like clarity on how ESMA intends the effectiveness of measures detailed in points 2, 3 and 4 to be verified, including the business continuity arrangements, the security procedures and arrangements, and the suitability of personnel. In general, we believe ESMA should take note of the existing practices and requirements at trading firms, which in concert with regulatory oversight are, in our view, the appropriate measures to ensure the sound operation of our trading activities, including electronic platforms. The guidelines suggested in the CP should not unnecessarily duplicate the current regulatory requirements which we believe to be adequate for investment firms such as ourselves.

**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?**

Please see our above comment in response to Q3.

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

We do not have further comments specifically on this section, though we refer back to the general caveats made in response to Q1 which apply here.

**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?**

We believe the draft guidelines are reasonably complete in most material aspects. However, it is hard to judge their appropriateness until measures currently described only in generic terms (e.g. the arrangements to prevent excessive flooding of the order book within point 2) are made more specific. We also refer back to our general comments in answer to Q1, which apply here.

**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?**

We would like more detail on the arrangements under point 2 to prevent the excessive flooding of the order book, and to set minimum requirements for members' pre- and post-trade controls. On these points, and on the question of circuit breakers (within the 'Explanatory notes', point 31) we believe it is critically important for ESMA to coordinate a consistent regional approach. We strongly believe that platforms should not have responsibility for "standards covering the knowledge of persons within members/participants and users that will be using the order entry systems". Finally, in respect of platforms' ability to "obtain information from a member/participant or user to facilitate monitoring of their compliance with the rules and procedures of the regulated market or multilateral trading facility relating to organisational requirements and trading controls", we believe this authority should be clearly limited in reach to the platform's members (e.g. an investment firm), and should not extend to the underlying clients using a member's services (e.g. institutional investors who are clients of the investment firm). We believe that current KYC policies, governed by

local regulators, and firm-specific client onboarding processes already provide the appropriate framework for an investment firm to perform due diligence on its clients.

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

We do not have further comments specifically on this section, though we refer back to the general caveats made in response to Q1 which apply here.

**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?**

As they stand, we do not believe the draft guidelines are sufficiently comprehensive or appropriate.

- Within point 2, we believe that the guidelines should recognise that investment firms do not necessarily have sufficient visibility on their clients' activities to judge whether they have "adequate funds or holdings of, or access to, the relevant financial instrument" for a given transaction. Institutional clients frequently use multiple executing brokers and/or prime brokers/custodians; it is therefore impractical for any single broker to hold a comprehensive view of a client's positions and holdings. We also believe it is important that guidelines pertaining to oversight are consistent with European-wide efforts to harmonise the short-selling regime. Finally, we note that the electronic capacity to support such a pre-trade check varies significantly by asset class. We believe a firm's settlement process as well as the contractual obligations/terms of business established during the on-boarding process adequately cover the spirit of the guideline.
- Within point 4, we are keen to emphasize that it should be within the sole judgement of an investment firm whether their personnel are of adequate training and calibre, so long as meeting all applicable pre-existing regulatory criteria such as standard FSA exams and approvals.

Within point 5, we believe it is important that trading desks retain primary responsibility within an investment firm for monitoring a complete record of clients' orders in as close to real time as practicable and in full. Moreover, Compliance groups within investment firms are likely to be most effective operating on an 'exceptions basis' where they prioritise their attention to flagged exceptions. Trading desks and trading supervisors provide an important 'first line of defence' in this regard, and we do not believe it is necessary to require Compliance groups to duplicate this resource intensive oversight for all firm's electronic trading systems. We believe their time is more valuably spent looking more selectively at trades that represent potential issues; without such an approach, there is a significant danger that they will not be able so readily to spot potential issues amongst the large volume of ordinary, valid trades. We also note the general inapplicability of this guideline to asset classes such as in Debt or Interest Rate products where electronic systems may cover only part of the trading life-cycle.

**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?**

Yes – as per our answer to Q11. We also refer back to the general caveats made in response to Q1 which apply here.

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

Yes – as per our answer to Q11. We also refer back to the general caveats made in response to Q1 which apply here.

**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?**

We refer back to the general caveats made in response to Q1 which apply here. In particular, we seek appropriate delineation (or clarity within the scope) for applicability to the various electronic trading methods that differ by asset class.

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

We refer back to the general caveats made in response to Q1 which apply here.

**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?**

- Yes: as per the response to previous questions, we would like clarity on how it should be judged that investment firms are satisfying the various criteria, which, in their current state are broad and may be subjective. For example, we believe that it should be the responsibility of the investment firm, within its sole discretion, that its staff are sufficiently competent (so long as satisfying all applicable pre-existing regulatory criteria) – Detailed guidelines, point 2. Also within point 2, we would reiterate our belief (consistent to our response to Q11 above) that the Compliance group should focus on monitoring day-to-day trading activity via an exceptions process, leaving the monitoring of all client trading (normal and exceptional) to the respective trading desks/supervisors: we believe this approach will enable the Compliance group to properly focus on potential issues and trading activity that falls outside predetermined parameters; any alternative would reduce the valuable ‘first line of defence’ role played by the business, who have the best client knowledge, and would bring about a disproportionate situation where the Compliance team would have to review all trading activity for potential issues, creating the serious risk of missed exceptions and/or issues that require their attention. As a general point, we believe that the nature of order and trade monitoring at a trading platform is fundamentally different from that required within an investment firm, and we believe the guidelines should clearly reflect this.
- Finally, we also note the general inapplicability of this guideline to asset classes such as in Debt or Interest Rate products where electronic systems may cover only part of the trading life-cycle.

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

In addition to the points made in response to Q16, we would stress the additional observation that since clients tend to operate with multiple brokers, it is unreasonable to expect an individual broker to know comprehensively and monitor the entirety of a client's activity with respect to potentially abusive behaviour. In addition, we refer back to the general caveats made in response to Q1 which apply here.

**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?**

We believe that the risk profiles associated with DMA and SA are different (both for trading platforms and for investment firms), and we believe that further detail would be helpful to recognise this distinction. In particular on SA, we believe it is important to place greater onus on trading platforms to demonstrate that their offerings are consistent with their general rulebook and promote the smooth functioning of orderly markets. Key examples of this include platforms ensuring that their gateway controls allow brokers to check those elements required to be under broker control as laid out in the respective rule books, and providing appropriate drop copy functionality to facilitate brokers' monitoring in near real-time the risk of the client's trading. These measures significantly contribute towards the control that platforms and investment firms have over such access since both provide the ability to cut off the client flow – but investment firms are dependent on platforms making available such drop copy functionality. On these points, therefore, it would be useful for ESMA to provide more detail to the market. We also refer back to the general caveats made in response to Q1 which apply here.

**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?**

In addition to comments made in response to Q18, we refer back to the general caveats made in response to Q1 which apply here.

**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?**

In addition to comments made in response to Q18, we refer back to the general caveats made in response to Q1 which apply here.

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

Please refer to our answer to Q18.

**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?**

We believe it would be helpful to have additional detail on guidelines as to what the checks should be (e.g. order size, price, cumulative positions, etc.). Certain de facto standards seem to have emerged informally across European venues that provide SA – but it would be useful if ESMA were to help formalise a consistent framework by providing additional detail. In particular, we believe clarification is required in the detailed guidelines paragraph 2, bullet 1 concerning the review of the “financial standing of the client”, referring also back to our response to Q11 where we indicated it was not practical for a broker to have a complete view of a client’s status. Also, we believe more clarity is required in the detailed guidelines, paragraph 2, bullet 3 concerning the “assessment of the potential market wide impact of orders likely to be sent”. In addition, we refer back to the general caveats made in response to Q1 which apply here. In addition, as per our responses elsewhere (e.g. to Q5) we believe that references to “training and competency” of relevant individuals at investment firms need to be set in the context of, and should not add to, existing regulatory requirements under which investment firms operate with respect to their personnel.

**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 crossborder activity and without imposing excessive costs on groups active in both the EEA and the US?**

As a general matter, BofAML supports the guidelines’ requirement for pre-and post-trade risk controls for investment firms providing DMA/SA market access. Whilst we believe they are generally consistent with the requirements laid out in the SEC’s Rule 15c3-5,, we would urge ESMA to work closely with the SEC to ensure appropriate harmonisation. As noted in the prior responses, greater clarity is required in the guidelines to help firms implement the required controls in an efficient manner that avoids business disruption and undue expense but also protects market integrity. Given the substantial volume of cross-border trading activity that occurs in today’s global markets, it would be unproductive for regulators to develop widely disparate regulatory regimes that do not share fundamental objectives and core elements. Rule 15c3-5 requires broker-dealers access providing market access to trade directly on an exchange or an ATS to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity. We would encourage ESMA to closely monitor the recent implementation of Rule 15c3-5 and observe how the US experience in adopting pre-trade controls and post-trade surveillance might better inform EEA initiatives to address regulatory concerns connected to DMA/SA and HFT.

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

We refer back to the general caveats made in response to Q1 which apply here.

Yes – we believe that this text is on balance helpful for market participants, and that it should be retained.

If you have any further queries in respect of this response or would like further information on any aspect, please do not hesitate to contact Daniela Marilungo (Public Policy) at [daniela.marilungo@baml.com](mailto:daniela.marilungo@baml.com) or Kate Lamburn (Legal) at [kate.lamburn@baml.com](mailto:kate.lamburn@baml.com).

3 October 2011

A handwritten signature in black ink, appearing to read 'Sajid Hussein', with a long horizontal stroke extending to the left.

General Counsel - EMEA