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Comments

on ESMA's Consultation paper "Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities" [ESMA/2011/224]

Contact:

Dr. Diedrich Lange

Adviser

Phone: ++49 – 30 – 2021 1610

e-mail: d.lange@bvr.de

Patrick Büscher

Adviser

Phone: ++49 – 30 – 20225 5346

e-mail: patrick.buescher@dsgv.de

We thank ESMA for the opportunity to comment on the Consultation paper “Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities”, here further referred to as Guidelines. We especially welcome the fact that ESMA has involved market participants prior to rolling out the guidelines and is soliciting their preliminary assessment of the policy under consideration. We take the liberty to comment on the guidelines in the form of some rather general remarks.

To some extent, we share ESMA’s concerns about the micro-structural changes in the financial markets caused by automated trading like algorithm trading and high frequency trading. In general, the resilience and integrity of the market is of the utmost importance and should not be endangered by techniques of trading, and especially not in the current critical market phase. We understand that ESMA is under pressure to take measures to ensure the integrity and the efficiency of the financial markets in Europe.

Therefore, we subscribe to ESMA’s viewpoint that the potential for market abuse, in particular market manipulation in a highly automated trading environment calls for regulatory action in the short term.

Likewise, it is intelligible that ESMA attempts to set the scene through the means of the Guidelines legally based on the MiFID as well as on best practices before the MiFID recast will take place and provide clarity with regard to the necessary definitions of algorithm trading and additional measures for market integrity. From our point of view, bridging the gap until the advent of MiFID II is a possible step when it comes to the regulation and supervision of trading platforms in the Guidelines. In this respect, we principally support ESMA’s approach.

However, when it comes to the guidelines for investment firms, we have some reservations and cannot underline ESMA’s proposal. This is due to the need of some realignment to take into account the wide variety and diversity of the investment firms with more than, as ESMA states in its impact assessment in Annex III¹, 2,500 investment firms and 3,100 credit institutions. We are bound to make an important caveat regarding the scope of the Guidelines for investment firms. We fully understand that the legal basis for the Guidelines is set by Article 13 MiFID and that therefore the meaning of the term electronic trading firms is foreseen as an anchor for supervisory measures. In addition to this, it is true that the highly automated trading environment of the markets today justify to a certain extent some sharpening of the principles on organization and compliance.

Nevertheless, we do not see that supervisory recommendations could go over and beyond what was laid as ground in the MiFID. This is however the case when the Guidelines even refer to electronic order routing systems as part of electronic trading systems² and demand to apply the full catalogue of measures enumerated in the detailed guideline 2³. It is imperative to draw a clear line between investment firms involved in the algorithm trading and those not engaged in this area. If there are no means of abstract definition at hand to split up the two parts of the market, the authorities as well as the trading platforms could demand the registration of algorithm traders.

¹ Consultation paper p. 57.

² Consultation paper p. 18, para. 27.

³ Consultation paper p. 17, para. 2.

In any case, the set of best practices sitting under guideline 2 should be divided into two sets to ensure the adequacy of the measures with regard to the size and the intensity of proprietary trading. The separation of the guidelines related to the specificities of the markets is especially needed when looking for example at the third indent bullet points 3 and 4 or the seventh indent under paragraph 2 on page 17 with obligations like the back-up sites or real time monitoring of trading etc. These and many of the other organizational requirements are too far reaching when being formulated in an absolute declaratory manner and without the necessary distinction as to the capacity of individual investment firms to trigger price movements or to cause market disorder. Guideline 2 as it stands is not acceptable for us.

At least, there should be a proportionality criterion confirmed within the Guidelines regarding their transposition by the national authorities, taking into account the differences between small and medium sized investment firms, as for example the co-operative banks and savings banks on the one hand, and large trading institutes being heavily involved in automated proprietary trading on the other hand. From our point of view, it is not sufficient to leave the issue of the proportionate transposition of the guidelines to the discretion of the national authorities; to the contrary, it should be clearly stated within the Guidelines, preferably as an introductory remark.

We would be pleased if you could take our comments on the consultation paper into account. Please do not hesitate to get into contact with us.