

3 October 2011

**ESMA Consultation Paper**

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

**Comments by AMAFI and FBF**

*Association française des marchés financiers (AMAFI)* has more than 120 members representing over 10,000 professionals who operate in the cash and derivatives markets for equities, fixed-income products and commodities. Nearly one-third of the members are subsidiaries or branches of non-French institutions.

*The French Banking Federation (FBF)* represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 500 commercial, cooperative and mutual banks. FBF member banks have more than 25,500 permanent branches in France. They employ 500,000 people in France and around the world, and service 48 million customers.

The Associations welcome the opportunity to comment on the Consultation paper (hereafter referred as to the “CP”) on “*Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities*” issued by the European Securities and Market Authority.

Before answering the questions of the “CP”, the associations would like to emphasise some general comments.

## **I) GENERAL COMMENTS**

Highly automated trading has increased significantly in the previous years. In particular, high frequency trading (HFT), which is one component of highly automated trading, is estimated to have grown from negligible amounts to an estimated 60-70% in equity trading volume in the US and to 30-50% within the EU. Even if the consequences of these developments on the overall quality of the market can be discussed, there is no doubt that there is a need to better control and monitor highly automated trading considering its importance. It is necessary to reinforce the prevention of the specific risks involved by highly automated trading by imposing sound systems of risk management. But above all, it is crucial to give supervisory bodies a common framework in order to assess the systems put in place either by operators of regulated markets (RMs) and multilateral trading facilities (MTFs) or by investment firms.

Having saying that and after a deep analysis of the guidelines proposed by the CP, the Associations consider that the draft guidelines can be divided into three main categories that are listed below.

First the guidelines that could easily be implemented by MRs, MTFs and investment firms because, according to the associations they should already be put in place within the legal framework currently existing. From this point of view the main interest of the guidelines is to ensure that market supervisors analyze this framework and its consequences on their supervisory duties in the same manner (see also on that point, response to Q1 below). This category mainly comprises:

- Organizational requirements for regulated markets' and multilateral trading facilities' electronic trading systems (general and details guidelines 1);
- Organizational requirements for investment firms' electronic trading systems" (general and details guidelines 2);
- Organizational requirements for regulated markets and MTFs to prevent market abuse (in particular market manipulation) in a highly automated trading environment (general and details guidelines 5);
- Organizational requirements for investment firms to prevent market abuse (in particular market manipulation) in a highly automated trading environment (general and details guidelines 6).

But even if the guidelines mentioned above could be implemented, the Associations would like to stress that ESMA should assess more deeply the following points.

- The setting up of identical guidelines for RMs and MTFs (see on that point, response to Q2 below).
- The setting up of identical guidelines for investment firms without taking into account the nature of the activity they carry out and the nature of the contractual relationship they may have with their clients (see on that point, response to Q5 below).
- The accuracy to set up specific guidelines in order to prevent market abuse in a highly automated environment (see on that point, response to Q15 and Q18 below).

Then the guidelines in areas where there is a need to carry out further works in order to achieve more consistency in the European market framework. In this category fall guidelines such as platform-based circuit breakers, minimum requirements for members' and participants' pre- and post-trade controls, standards covering the knowledge of persons within members/participants and users that will be using order entry systems... For us these provisions should be harmonized at the European level and are not in a field where competition between trading venues seems appropriate.

Last the guidelines that should be totally reviewed by ESMA because they are not appropriate. This category comprises various issues such as guidelines concerning:

- the possibility given to a RM or MTFs to prevent the excessive flooding of the order book at any one moment in time, or mechanism put in place for slowing down order flow from members;

- the guidelines which oblige investment firms to block client's orders in circumstances where they have no means to control that the clients comply with their own rules or applicable regulations (e.g. to if the client does not have adequate funds or holdings of, or access to, the relevant financial instrument to complete the transaction.... );
- the guidelines which impose compliance staff to monitor in real time the order flow of the investment firm.

Besides that and concerning direct market access (DMA) and sponsored access (SA), the Associations consider that what is called "Naked SA", that is to say an SA arrangement without any pre trade control done by the investment firm, should be clearly prohibited. Indeed, it would be contradictory to impose, by these guidelines, more constraints on intermediaries and to let the possibility that an entity which is not regulated intermediary to have a direct access to a RM. In that perspective, the Associations wonder whether the difference made between SA and DMA arrangements is relevant because if a pre trade control is required, there is no situation where the definition of SA "*electronically transmit orders for execution directly to the market without using the intermediary's infrastructure*" fits. At least, the guidelines should be clarified in order to:

- impose a recorded, legally binding contract between the intermediary and the DMA/SA customer. A tree party's contract could be signed between the intermediary, the DMA/SA customer and the market in order to define precisely the roles and responsibilities of each party;
- mandate pre-trade control for SA arrangements. The responsibility assumed by the market should be defined in the tree-parties contact mentioned above.

## II) ESMA questions and draft guidelines.

***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?***

As stated above, there is a need to give regulators tools to better monitor and control these activities and to achieve a consistency of approach across European jurisdictions. Guidelines by ESMA have an interest for market participants only if they permit to reach greater harmonization of the European level playing field. However, from this point of view AMAFI and FBF are forced to see that the reality is quite different since all regulators do not apply in the same way the guidelines. While some apply strictly and rigorously, this is not the case for all ...

The Associations consider that ESMA should only adopt such guidelines if there is a commitment of each ESMA's member to implement them fully and in the same way.

In this case, given the fact that it is anticipated that the review of MIFID will take time before entering into force, waiting for greater harmonization in an area of that importance would certainly be counterproductive. But, as stated in the general comments above, many of the draft guidelines cannot be implemented without any further consideration.

## **A) Draft guidelines on electronic trading systems for trading platforms and investment firms**

### **a) Trading platforms**

#### **Guideline 1: Organisational requirements for regulated markets' and multilateral trading facilities' electronic trading systems**

##### *General guideline*

1. A regulated market's or multilateral trading facility's electronic trading system (or systems) should enable it to comply with its obligations under MiFID and other relevant Union and national law taking into account technological advancements and trends in the use of technology by its members/ participants or users and, in particular, should enable it to ensure continuity and regularity in the performance of the market (or markets) operated by it.

This statement is obvious. It is not a general guideline but a description of what is required under the current rules. As such, the words "should enable" are not appropriate: the words "shall enable" are imperative.

##### *Detailed guidelines*

2. In following the general guideline regulated markets and multilateral trading facilities should at least:
  - develop, procure (including outsourcing) and monitor their electronic trading systems through a governance process that embeds compliance and risk management principles and involves a clear process for accountability, communication of information and sign-off for initial deployment, subsequent updates and resolution of problems identified through monitoring;
  - have electronic trading systems with sufficient capacity to accommodate reasonably foreseeable volumes of messaging and that are scalable to allow for capacity to be easily and rapidly increased in order to respond to rising message flow and emergency conditions that might threaten their proper operation, in particular through controls on message flows through a 'normal activity/ maximum IT capacity' ratio;
  - have effective business continuity arrangements in relation to their electronic trading systems covering such matters as:
    - governance for the development and deployment of the arrangements;
    - consideration of an adequate range of possible scenarios related to the operation of their electronic trading systems which require specific continuity arrangements;
    - the backing up of business (including compliance) critical data that flows through their electronic trading systems;
    - the procedures for moving to and operating the electronic trading system from a back-up site;
    - staff training on the operation of the arrangements and individuals' roles within them;and

- an ongoing program for the testing, evaluation and review of the arrangements including procedures for modification of the arrangements in light of the results of that program.
  - prior to deploying an electronic trading system, and prior to deploying updates to an electronic trading system, make use of clearly delineated development and testing methodologies to seek to ensure that, amongst other things, the operation of the electronic trading system is compatible with the regulated market's and multilateral trading facility's obligations under MiFID and other relevant Union or national law, that compliance and risk management controls embedded in the systems work as intended (including generating error reports automatically) and that the electronic trading system can continue to work effectively in stressed market conditions;
  - monitor in real time their electronic trading systems, deal adequately with problems identified as soon as reasonably possible in order of priority and be able when necessary to adjust or shut down the electronic trading system in an orderly manner;
  - periodically review and evaluate the governance, accountability and sign-off framework, the electronic trading systems and their business continuity arrangements so as to ensure their continued appropriateness and act on the basis of these reviews and evaluations to remedy deficiencies;
  - have procedures and arrangements for physical and electronic security designed to protect electronic trading systems from misuse or unauthorized access and to ensure the integrity of the data that is part of or passes through the systems; and
  - have procedures and arrangements to ensure they employ sufficient number of staff with the necessary skills and expertise to manage their electronic trading systems, including staff with appropriate knowledge of relevant systems, the monitoring and testing of such systems and the sort of trading that will be undertaken by members/participants of the regulated market or users of the multilateral trading facility.
3. Regulated markets and multilateral trading facilities should keep records in relation to their electronic trading systems covering at least the matters referred to in paragraph 2.
  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.

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

ESMA's proposes to set up identical guidelines for RMs and MTFs. For us, the detailed guidelines have to be better calibrated in order to take into account that under MIFID, RMs and MTFs are not entities of exactly the same nature. According to the definition of MIFID<sup>1</sup>, RMs do have an obligation to "function regularly" when MTFs do not. Of course, as it is stated in the CP, MTFs have to comply with article 13 of MIFID<sup>2</sup> but the level of these rules is not the same as that which requires RMs to function regularly; If it

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<sup>1</sup> Article 4 – 14 "Regulated market" means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments - in the system and in accordance with its non-discretionary rules - in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with the provisions of Title III".

<sup>2</sup> Article 13 includes obligations on continuity and regularity in the performance of investment services and activities risk management, employing personnel with the right skills and expertise, internal audit.....

should be considered that a RM and a MTF should comply with exactly the same rules, therefore the question of the distinction between these two venues should seriously be raised.

This is a very important issue which ESMA have to take into account. See also on that question, developments about investment firms' general guideline below.

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

See above.

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

See above.

## **b) Investment firms**

### **Guideline 2: Organizational requirements for investment firms' electronic trading systems (including trading algorithms)**

#### *General guideline*

1. Investment firms' electronic trading systems, including trading algorithms, should enable the firm to comply with its obligations under MiFID and other relevant Union and national laws as well as the rules of the regulated markets and multilateral trading facilities to which it sends orders in order to ensure continuity and regularity in the performance of its investment services and activities in a highly automated trading environment.

As for trading venues, the first part of this statement is obvious. It is not a general guideline but a description of what is required under the current rules. As such, the words "should enable" are not appropriate: the words "shall enable" are imperative.

On the other hand, the second part of it can be discussed whether investment firms have "*to ensure continuity and regularity in the performance of its investment services and activities in a highly automated trading environment*", from a market surveillance perspective.

The question cannot be considered independently of the contractual relationship with the customer and the conditions under which it was agreed that the service would be provided. The client may wish to obtain this guarantee and then would agree to pay the price for having continuity and regularity of service through a "Service Level Arrangement". But the client could also prefer to pay a lower price and having less insurance. The setting up of this guideline would narrow the field of competition within investment firms, probably at the expenses of the investor's interest.

The question of course is even enhanced when the investment firms carry out a pure proprietary activity (without any relationship with a client). In this situation, the investment firm should have the right to determine the level of risk it is willing to assume in terms of continuity of its tools.

In any case, the last part of the sentence (“in a highly automated trading environment”) needs to be deleted. It adds confusion to the goal pursued.

#### *Detailed guidelines*

2. In following the general guideline, investment firms should at least:
  - develop, procure (including outsourcing) and monitor their electronic trading systems, including trading algorithms, through a governance process that embeds compliance and risk management principles and involves a clear process for accountability, communication of information and signoff for initial deployment, subsequent updates and resolution of problems identified through monitoring;
  - have electronic trading systems with sufficient capacity to accommodate reasonably foreseeable volumes of messaging and that are scalable to allow for capacity to be easily and rapidly increased in response to rising message flow, in particular through ongoing monitoring and controls on message flows through a ‘normal activity/maximum IT capacity’ ratio;
  - have effective business continuity arrangements in relation to their electronic trading systems covering such matters as:
    - governance for the development and deployment of the arrangements;
    - consideration of an adequate range of possible scenarios related to the operation of their electronic trading systems which require specific continuity arrangements;
    - the backing up of business (including compliance) critical data that flows through their electronic trading systems;
    - the procedures for moving to and operating the electronic trading system from a back-up site;
    - staff training on the operation of the arrangements and individuals’ roles within them; and
    - an ongoing programme for the testing, evaluation and review of the arrangements including procedures for modification of the arrangements in light of the results of that programme.
  - prior to deploying an electronic trading system, or a trading algorithm, and prior to deploying updates, make use of clearly delineated development and testing methodologies to seek to ensure that, amongst other things, the operation of the electronic trading system or trading algorithm is compatible with the investment firm’s obligations under MiFID and other relevant Union and national laws as well as the rules of the trading platforms they use, that the compliance and risk management controls embedded in the system or algorithm work as intended (including generating error reports automatically) and that the electronic trading system or algorithm can continue to work effectively in stressed market conditions;
  - adapt trading algorithm tests (including tests outside live trading environments) to the strategy the firm will use the algorithm for (including the markets to which it will send orders and their structure) and ensure they are commensurate with the risks that this strategy may pose to the investment firm as well as to the fair and orderly functioning of the markets operated by the trading platforms the firm uses;
  - roll out the deployment of trading algorithms in a live environment in a controlled fashion;
  - monitor in real time their electronic trading systems, including trading algorithms, deal adequately with problems identified as soon as reasonably possible in order of priority and be able when necessary to adjust or immediately shut down their electronic trading system or trading algorithm in an orderly manner;
  - periodically review and evaluate the governance, accountability and sign-off framework for electronic trading systems and trading algorithms, the trading systems and algorithms

- themselves and their business continuity arrangements so as to ensure their continued appropriateness and act on the basis of these reviews and evaluations to remedy deficiencies;
- have procedures and arrangements for physical and electronic security designed to protect electronic trading systems and trading algorithms from misuse or unauthorised access and to ensure the integrity of the data that is part of or passes through the systems and algorithms; and
  - have procedures and arrangements for ensuring that they employ sufficient staff with the necessary skills and expertise to manage their electronic trading systems and trading algorithms, including staff who have appropriate knowledge of relevant IT systems and algorithms, the monitoring and testing of such systems and algorithms, and knowledge of the sort of trading strategies that the firm deploys through its trading systems and algorithms.
3. Investment firms should keep adequate records of their electronic trading systems (and trading algorithms) including at least the matters covered in paragraph 2.

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

As noted above, these guidelines must be adapted to reflect, on one side the level of continuity of service agreed with the customers, on the other side, when pure proprietary trading is carried out, the risk accepted by the investment firm.

From this point of view, the requirements relating to compliance with the functioning of the market should not be treated here but in Part B below.

***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?***

See above.

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

See above.



## **B) Draft guidelines on organisational requirements for trading platforms and investment firms to promote fair and orderly markets in a highly automated trading environment**

### **a) Trading platforms**

#### **Guideline 3: Organisational requirements for regulated markets and multilateral trading facilities to promote fair and orderly trading in a highly automated trading environment**

##### General guideline

1. Regulated markets' and multilateral trading facilities' rules and procedures for fair and orderly trading should be appropriate to an increasingly automated trading environment and the nature and scale of trading on their markets, including the types of members and participants and their trading strategies.

As stated above, this statement is obvious. It is not a general guideline but a description of what is required under the current rules. As such, the words "should be appropriate" are not adequate: the words "shall be appropriate" are imperative.

##### Detailed guidelines

2. In following the general guideline, the rules and procedures of regulated markets and multilateral trading facilities should at least include:
  - the ability to prevent in whole or in part the access of a member or participant to the trading facility and to cancel, amend or correct a transaction;
  - arrangements to prevent the excessive flooding of the order book at any one moment in time, notably through limits per participant on order entry capacity;

Given that there is no definition of what "excessive flooding of the order book" is, we consider that this guideline is not appropriate. Such a provision could lead to a discriminatory decision of a trading venue which could limit the order entry capacity of some participants at the expense of others.

- arrangements to prevent capacity limits from being breached through a mechanism for slowing down order flow from members/participants and users which restricts the number of messages of any individual member/participant or user within a set timeframe in the event that there is a danger of capacity limits being reached;

This guideline is not appropriate. There is no possibility to set up an appropriate rule concerning the adequate speed of the order flow and the number of message a participant can send in a given period of time. Therefore such a provision could lead to a discriminatory decision of a trading venue which could slow the order flow of some participants or limit the number of messages at the expense of others.

- arrangements to constrain trading or halt trading in individual or multiple financial instruments when necessary, on both an automatic and discretionary basis, to maintain an orderly market. This may include automatic rejection of orders which are outside of certain set volume and price thresholds;

The Associations believe that in this area, platform-based circuit breakers should be mandated. The circuit breakers should be harmonized within Europe and based on “volatility-interruptions”. The circuit breaker should be put in place in order to prevent that an order which is send to the market changes the price of the financial instrument of more than a given percentage of the previous quote.

- standardised testing to ensure that the systems that members and participants are using to access the venue have a minimum level of functionality that is compatible with fair and orderly trading on the venue;
- minimum requirements for members’ and participants’ pre- and post-trade controls (including controls to ensure that there is no unauthorised access to trading systems) to ensure that there is orderly trading on the venue, in particular requirements for filtering order price and quantity (this requirement is without prejudice to the primary responsibility of members/participants or users to implement their own pre- and post-trade controls);

The Associations agree with this guideline but consider that those requirements should be harmonized at the European level. In the MIFID environment where investment firms are obliged to trade on various trading venues, harmonization of requirements due by member’s participants is necessary in order to avoid costs and risks in an area where competition within trading venues is not relevant.

- standards covering the knowledge of persons within members/participants and users that will be using order entry systems;

The Associations consider that the training policy is a critical issue that can not only be solved by an ESMA’s guideline. Our members have raised their concerns on the great diversity of training policies (content, frequency and modalities) toward traders which actually vary radically depending on the exchange or the regulatory framework of investment firms host country.

For us the training policy should be harmonized at the European level and could be based on the following principals: a harmonized European program (estimated at 80%) which would be completed by local modules (20% of the program content); the training would be provided by entities certified by national regulators under the leadership of either ESMA or the European Commission.

- where applicable, clear organisational requirements for members or participants who are not credit institutions or investment firms, including requirements on the monitoring of trading against the rules of the venue and the management of risk; and

We fully agree with this guideline which is necessary before the implementation of the new MIFID provisions. For us, MIFID should be amended in order having all entities involved at least in high frequency trading activities regulated and supervised.

- the 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.

3. Regulated markets and multilateral trading facilities should keep adequate records of the matters covered by paragraph 2.

**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?**

The Associations consider that the proposed guidelines should be modified in order to achieve more constancy within Europe in some critical areas such as circuit breaker, trading policy and requirements for members. Besides that, we are not in favor of the guidelines concerning the capacity of a market venue to constrain the flow or the speed of orders given the lack of rules and common consensus on what the appropriate level could be.

**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?**

The Associations do not see the need of any additional guidelines at this stage.

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

The Associations do not have any additional comments.

## **b) Investment firms**

### **Guideline 4: Organisational requirements for investment firms to promote fair and orderly trading in a highly automated trading environment**

#### General guideline

1. Investment firms should have adequate policies and procedures to ensure that their highly automated trading activities on regulated markets and multilateral trading facilities comply with their regulatory requirements under MiFID and other relevant Union and national laws and, in particular, manage the risks relating to those trading activities

As already stated above, this statement is obvious. It is not a general guideline but a description of what is required under the current rules. As such, the words “should have” are not appropriate: the words “shall have” are imperative.

## Detailed guidelines

2. In following the general guideline, investment firms' electronic trading systems should automatically block or cancel orders:

- that do not meet set price or size parameters (differentiated as necessary for different financial instruments), either on an order-by-order basis or over a specified period of time, or because orders appear to be duplicative;

The Associations consider that the minimal requirement should only be calibrated at the same level than the trading halt (on a harmonized basis at the European level) set up by the trading venues. If the goal of this guideline is to ensure the well functioning of the market, it cannot rely on various specific rules set up by various trading venues.

- if the client does not have adequate funds or holdings of, or access to, the relevant financial instrument to complete the transaction;

For us, this provision is not applicable. In the European environment, investment firms that deal for professional clients are not the entities which hold the assets of the clients. Therefore, it is concretely impossible for them to assess whether the client have adequate funds or holdings to complete the transaction when it transmit an order to a broker.

On this subject, we would like to point it out that there are various regulations currently discussed at the European level concerning short selling, Central Depositories or Securities Law. Therefore, there is no reason that ESMA preempts the solutions that could be implemented identified by these coming EU regulations.

- if they are for a financial instrument that a trader does not have permission to trade;
- where they would be inconsistent with a firm's obligations under MiFID, such as the client order handling rules, or other relevant Union or national legislation, or under the rules of the RM or MTF to which the order is to be sent (including rules relating to fair and orderly trading); and

For us, it is not appropriate to refer to client order handling rules. The investment firm does not have the capacity to know and assess that the order sent by the client is compliant with the client's internal procedures.

- where they risk compromising the firm's own risk management and/or capital adequacy thresholds, applied as necessary and appropriate to exposures to individual clients or financial instruments or groups of clients or financial instruments, exposures of individual traders, trading desks or the investment firm as a whole.

3. Investment firms should have procedures and arrangements for dealing with orders which have been automatically blocked by the firm's pre-trade controls but which the investment firm wishes to submit. These procedures and arrangements should make compliance and risk management staff, as necessary, aware of when controls are being overridden and require their approval for the overriding of these controls.

The Associations consider that this guideline should be precised. The first level of control (and the right to submit an order that has been automatically blocked) should remain at the "business line" level. The approval of compliance and risk management staff in all situations would be impracticable and not necessary if we consider the level of risk concerned in the vast majority of situations.

In that respect, the words "as necessary" are not clear on the possibility to leave the choice on the business line level to ask for the approval of compliance and risk management. Moreover, it must be noticed that the tasks of compliance and risk management teams are completely different because the risks they have to manage are fully different in nature. For us, the guidelines should be focused on compliance issues, risk issues being regulated by Capital Adequacy Directives (CRDs). ESMA should at least clarify what falls under compliance staff and risk management staff.

4. Investment firms should ensure that employees involved in order entry have adequate training on order entry procedures, including complying with requirements imposed by RMs and MTFs, before they are allowed to use order entry systems.

As stated above, we consider that the training policy is a critical issue that can not only be solved by an ESMA's guideline. For us the training policy should be harmonized at the European level and could be based on the following principals: harmonized European program (estimated at 80%) which would be completed by local modules (20% of the program content); the training would be provided by entities certified by national regulators under the leadership of either ESMA or the European Commission.

5. Investment firms should ensure that compliance staff has a feed of the firm's orders in as close to real time as possible and have systems for monitoring those orders.

For us there is no need for the compliance staff to have a feed of the firms orders flow in as close to real time as possible and to have systems for monitoring the orders. This provision is totally impracticable considering the number of orders and the speed at which there are treated. It would be concretely impossible for compliance staff to monitor the order flow in real time.

An ex post monitoring would be more appropriate. What matters is that the investment firm is able to follow closely enough the activity of electronic trading in order to quickly correct the failures. Anyway, if the investment firm undermines the proper functioning of the market, it may be held liable

6. Investment firms should ensure that they have control of messaging traffic to individual trading platforms to avoid overcrowding the systems of the trading platform.
7. Investment firms should manage the operational risks in electronic trading through appropriate and proportionate governance arrangements, internal controls and internal reporting systems.
8. Investment firms should keep adequate records of the matters covered by paragraphs 2 to 7. For investment firms' records to be adequate, they should be sufficiently detailed so as to allow competent authorities to appropriately supervise and monitor investment firms' trading activities,

and assess the conformity of these activities with MiFID, MAD and any other relevant European and national legislation.

**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?**

The Associations consider that the proposed guidelines have to be seriously reassessed. Some oblige investment firms to block client's orders in circumstances where they have no means to control that the clients comply with their own rules or applicable regulations. Others are inapplicable and disproportionate with the reality of the risks they intend to prevent.

**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?**

The Associations do not see the need of any additional guidelines at this stage.

**Q 13 Do you have additional comments on the draft guidelines on organisational requirements for investment firms to promote fair and orderly trading?**

The Associations do not have any additional comments.

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

**a) Trading platforms**

**Guideline 5: Organisational requirements for regulated markets and MTFs to prevent market abuse (in particular market manipulation) in a highly automated trading environment**

General guideline

1. Regulated markets and multilateral trading facilities should have effective arrangements and procedures which enable them to identify conduct by their members/participants and users that may involve market abuse (in particular market manipulation) in a highly automated trading environment.

As already stated above, this statement is obvious. It is not a general guideline but a description of what is required under the current rules.

Detailed guidelines

2. In following the general guideline, the arrangements and procedures of regulated markets and multilateral trading facilities which seek to prevent and identify conduct by their

members/participants and users that may involve market abuse and in particular market manipulation in a highly automated trading environment should at least include:

- having adequate systems (including automated alert systems on transactions and orders) with sufficient capacity to accommodate high frequency generation of orders and transactions and low latency transmission, in order to monitor, using a sufficient level of time granularity, orders entered and transactions undertaken by members/participants and users and any behaviour which may involve market abuse (in particular market manipulation) and with the ability to trace backwards transactions undertaken by members/participants and users as well as orders entered/cancelled which may involve market manipulation;
- having in place clear procedures for ensuring that conduct that may involve market abuse and in particular market manipulation is reported to the relevant competent authority (or authorities) without delay in accordance with the requirements under Articles 26(2) and 43(2) of MiFID and Article 6(9) of MAD;

As already stated above, this statement is obvious. It is not a detailed guideline but a description of what is required under the current rules.

- having sufficient staff with the understanding and skill to monitor trading activity in a highly automated trading environment and identify behaviour giving rise to suspicions of market abuse; and
  - conducting periodic reviews and internal audits of procedures and arrangements to prevent and identify instances of conduct that may involve market abuse
3. Regulated markets and multilateral trading facilities should keep adequate records of the matters covered by paragraph 2.

**Q14 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?**

The Associations do not see the need of any additional guidelines at this stage. The proposed guidelines to prevent market manipulation are consistent with the current regulatory provision.

**Q15: Do you have additional comments on the draft guidelines on organisational requirements for trading platforms to promote fair and orderly trading?**

Those guidelines consist of a description of what is already required under the current rules. The rationale behind setting up specific guidelines to prevent market abuse in a highly automated trading environment is not obvious. Indeed, many of them do not specifically concern highly automated trading but all kind of activities. Moreover, it will be difficult to assess whether an activity or an entity has to comply with the guidelines. Therefore, and even if we understand that it does not totally fit with the scope ESMA has to deal with, those guidelines should be put in place for all kind of activities. Another way to deal with this issue could be to better calibrate the guidelines to highly automated trading.

## b) Investment firms

### **Guideline 6: Organisational requirements for investment firms to prevent market abuse (in particular market manipulation) in a highly automated trading environment**

#### General guideline

1. Investment firms should have policies and procedures in place to minimise the risk that their highly automated trading activity gives rise to market abuse (in particular market manipulation). The policies and procedures should take into account the highly automated trading environment and the nature, scale and complexity of the firm's trading activity in this respect and the nature and range of investment services and activities that the firm undertakes.

#### Detailed guidelines

2. In following the general guideline the policies and procedures of investment firms engaging in highly automated trading activities should at least include:
  - procedures to seek to ensure that staff exercising the compliance function has sufficient understanding, skill and authority to challenge staff responsible for trading when the trading activity gives rise to suspicions of market abuse (in particular market manipulation);
  - initial and regular refresher training on what constitutes market abuse (in particular market manipulation) for all individuals involved in executing orders on behalf of clients and dealing on own account ;

This detailed guideline is not specific to a highly automated trading activity.

- monitoring the activities of individuals/algorithms trading on behalf of the firm and the trading activities of clients, taking account of orders submitted, modified and cancelled as well as transactions executed, and adequate systems in place (including automated alert systems), using a sufficient level of time granularity, to flag any behaviour likely to give rise to suspicions of market abuse (in particular market manipulation);
  - adequate arrangements to identify transactions and orders that require a Suspicious Transaction Report (STR) to competent authorities in relation to market abuse (in particular market manipulation) and to make those reports without delay;
  - periodic reviews and internal audits of procedures and arrangements to prevent and identify instances of conduct that may involve market abuse; and
  - frequently reviewed arrangements governing the access of staff to trading systems.
3. Investment firms should keep adequate records of the arrangements and procedures to identify conduct that may involve market abuse covering the matters set out in paragraph 2.



**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?**

The Associations do not see the need of any additional guidelines at this stage. The proposed guidelines to prevent market manipulation are consistent with the current regulatory provision.

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

Those guidelines consist of a description of what is already required under the current rules. The rationale behind setting up specific guidelines to prevent market abuse in a highly automated trading environment is not obvious. Indeed, many of them do not specifically concern highly automated trading but all kind of activities. Moreover, it will be difficult to assess whether an activity or an entity has to comply with the guidelines. Therefore, and even if we understand that it does not totally fit with the scope ESMA has to deal with, those guidelines should be put in place for all kind of activities. Another way to deal with this issue could be to better calibrate the guidelines to highly automated trading.

## **D) Guidelines on direct market access and sponsored access**

### **a) Trading platforms**

#### **Guideline 7: Organisational requirements for RMs and MTFs whose members/participants and users provide direct market access/sponsored access**

##### General guideline

1. Regulated markets and multilateral trading facilities should have rules and procedures which seek to ensure that, where they allow members/participants or users to provide direct market access/sponsored access, the provision of direct market access/sponsored access is compatible with fair and orderly trading and arrangements aimed at preventing and detecting market manipulation.

As stated in the general comments above, the Associations wonder whether the difference made between SA and DMA arrangements is relevant. It is not coherent to state that one side, SA is defined by “electronically transmit orders for execution directly to the market without using the intermediary’s infrastructure” and, on the other side to set up a guideline which “require the member/ participant or user to have adequate systems and controls to ensure that the provision of direct market access/sponsored access does not adversely affect compliance with the rules of the regulated market or multilateral trading facility, lead to disorderly trading or facilitate conduct that may involve market abuse”.

##### Detailed guidelines

2. In following the general guideline, regulated markets and multilateral trading facilities should set out whether or not it is permissible for their members/participants or users to offer direct market access and/or sponsored access. Where they allow members or participants to offer direct market access and/or sponsored access their rules and procedures should at least:

- make clear that the member/participant or user is responsible for all orders entered under its trading codes;
- require the member/ participant or user to have adequate systems and controls to ensure that the provision of direct market access/sponsored access does not adversely affect compliance with the rules of the regulated market or multilateral trading facility, lead to disorderly trading or facilitate conduct that may involve market abuse;

See above.

- require the member/ participant or user to conduct due diligence on any client to which it provides direct market access/sponsored access;
  - allow the regulated market or multilateral trading facility to refuse a request from a member/ participant or user to allow a client to be provided with sponsored access where the regulated market or multilateral trading facility is not satisfied that this would be consistent with its rules and procedures for fair and orderly trading;
  - allow the regulated market or multilateral trading facility to suspend or withdraw the sponsored access after it has been granted where the regulated market or multilateral trading facility is not satisfied that continued access would be consistent with its rules and procedures for fair and orderly trading; and
  - have the ability to stop orders from a person trading through sponsored access separately from the orders of the member or participant sponsoring that person's access.
3. Regulated markets and multilateral trading facilities should keep adequate records of the matters covered in paragraph 2.

**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?**

See above.

**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?**

The Associations do not see the need of any additional guidelines at this stage.

**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?**

The Associations do not have any additional comments.

## b) Investment firms

### **Guideline 8: Organisational requirements for investment firms that provide direct market access and/or sponsored access**

#### General guideline

1. Investment firms offering direct market access/sponsored access to clients ('direct market access/sponsored access clients') are responsible for the trading of those clients and should establish adequate policies and procedures to ensure the trading of those clients complies with the rules and procedures of the relevant regulated markets and multilateral trading facilities to which the orders of such clients are submitted and enables the investment firm to meet its obligations under MiFID and other relevant Union and national law.

As stated above, the associations wonder whether the difference made between SA and DMA arrangements is relevant.

#### Detailed guidelines

2. In following the general guideline above, the policies and procedures covering the activities of direct market access/sponsored access clients should at least include:
  - criteria, differentiated as necessary between direct market access and sponsored access, which a client has to meet in order to be suitable for direct market access/sponsored access covering such issues as the training and competency of individuals entering orders, access controls over order entry, allocation of responsibility for dealing with actions and errors and financial standing of the direct market access/sponsored access client;
  - assessment, periodically reviewed if the person is accepted as a direct market access/sponsored access client of prospective clients against the criteria for direct market access/sponsored access clients and clear procedures for signing off on the acceptance of direct market access/sponsored access clients;
  - an assessment, periodically reviewed, of the trading activities of direct market access/sponsored access clients to assess the potential market wide impact of the orders that are likely to be sent to the relevant regulated markets and multilateral trading facilities;
  - appropriate credit thresholds for each client, reviewed on a regular basis, for which an investment firm provides direct market access/sponsored access, which will include an overall credit threshold and potentially credit thresholds in relation to specific financial instruments based on appropriate due diligence as to the direct market access/sponsored access client's financial condition, trading patterns and order entry history;
  - pre-trade controls on the orders of direct market access/sponsored access clients of the sort covered in paragraph 2 of Guideline 4 on organisational requirements for investment firms to promote fair and orderly trading in a highly automated trading environment;
  - clarity that the investment firm should solely be entitled to modify the parameters of the pre-trade controls (the direct market access/sponsored access client should not be able to do so);
  - a real-time feed of orders entered and trading done by a direct market access/sponsored access client which separately identifies those orders and trades from the orders and trades of other clients and proprietary trades of the firm to enable the investment firm to check that direct market access/sponsored access clients' trading is compatible with the rules of

- relevant regulated markets and multilateral trading facilities and to help identify conduct that may involve market abuse, in particular, market manipulation;
- the ability to immediately halt trading by individual direct market access/sponsored access clients; And
  - documentation of the rights and obligations of both parties in relation to the direct market access/ sponsored access service.
3. Investment firms should keep adequate records of the matters covered in paragraph 2.
4. Investment firms offering direct market access/sponsored access can use pre- and post-trade controls which are proprietary controls of the investment firm, controls bought in from a vendor, controls provided by an outsourcer or controls offered by the venue itself (they should not be the controls of the direct market access/sponsored access client). However, in each of these circumstances the investment firm remains responsible for the effectiveness of the controls and has to be solely responsible for setting the key parameters.

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

For us there is a need to put in place a clear guideline which mandate pre-trade control SA arrangements.

**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?**

The Associations do not see the need of any additional guidelines at this stage.

**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?**

For us, naked SA arrangement should be prohibited at an international level.

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

As stated in the general comments above, the associations consider that a recorded, legally binding contract between the intermediary and the DMA/SA customer based on the ESMA's guidelines should be signed. A three party's contract could also be signed between the intermediary, the SA customer and the market in order to define precisely the roles and responsibilities of each party.

**General question regarding the draft guidelines in Annex VII to this CP:**

**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?**

The Associations consider that an explanatory text would be very helpful. Of course, the text should be modified in order to take into account the comments made by the respondents to the consultation and the new drafting of the guidelines.



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