



ESMA consultation paper on guidelines on systems and controls of trading venues and investment firms. (Direct electronic access). July 2011.

CESR (ESMA's predecessor) established, on November 2010, a Task Force on micro-structural current issues of the markets (high frequency trading, algorithmic trading, sponsored access, co-location, tick size" etc.), and ESMA has published, on the 20th of July a consultation paper about guidelines on Systems and controls of both trading venues and investment firms in a highly automated trading environment -including Direct Electronic Access (DEA)- and for investment firms acting as general clearing members. These guidelines sit under the existing legal Framework provided by MiFID and MAD (Market Abuse Directive) -currently under review- so it will be necessary for ESMA to revisit these guidelines, if adopted, to consider whether they need also to be revised or withdrawn in the light of the new legislation framework.

Guidelines on electronic trading systems.

Trading platforms should: have an adequate governance to comply with regulatory obligations: clear and formalised procedures to ensure that relevant considerations (commercial, technical, risk and compliance) are given due consideration in making the key decisions; be adaptable to business that take place (including the flow of message traffic the day with the highest volume) and develop continuity plans in the event of system failure; prior tests and independent periodic of compliance and risk management controls; have staff with necessary skills and expertise kept up to date; keep adequate records; and cooperate with competent authorities and report any information of significant risks to the sound operation of electronic trading.

Investment firms should: have a specific governance for algorithmic trading and monitor it as close to real-time as possible; have tests to ensure that an algorithm works as intended from the technical, regulatory and commercial point of view; have a monitoring system with alerts (that assist staff in identifying when an algorithm is not behaving as expected); and keep a record with relevant information that explains the trading strategies.

Guidelines on fair and orderly markets for trading platforms and compliance and risk Management controls for investment firms.

Trading platforms should: set up controls (on members/participants/users) about order entry, reject orders which appear to be erroneous and limited orders; ensure that the members/participants/users's IT systems are compatible with the platform's one; have circuit breakers or automatic mechanisms to stop trading in a specific financial instrument or more widely in response to significant variations in price to prevent trading becoming disorderly; regulate market access; and keep adequate records in relation to policies and procedures to ensure fair and orderly markets.

Investment firms should: put in place the necessary procedures to stop erroneous entry orders (outsider pre-determined parameters covering price, volume and parameters); have management risks systems to stop orders out when they breach credit limits set for the account of clients; delete pre-trade controls in some circumstances; and cover, as part of the operational risk, the arrangements to prevent fraud by employees.

Guidelines on market abuse.

Trading platforms should: put in place systems to monitor orders and transactions with the aim of flagging possible instances of conduct that might involve market manipulation that will need to be frequently reviewed to ensure that they can produce the relevant information to these effects; have a qualified staff that can follow up information provided by automatic alerts and decide appropriate course of action; report instances of possible market manipulation to their competent authority; and keep records with relevant information and audit trails regarding how each alert is dealt with.

Investment firms should: have procedures to ensure that relevant staff knows what to do when they become aware of transactions that might constitute a suspicious one so that the firm is able to discharge its responsibility under MAD; make Suspicious Transaction Reports (STRs) to the competent authorities and, given the nature of highly automated traded, suspicious reports should also be extended to orders entered, modified or cancelled, even if they did not produce any transaction.

Guidelines on Direct Electronic Access (DEA).

ESMA uses a DEA concept -more restricted than the one IOSCO uses- because there is always a market member implied and consists on the client's direct access to the market using the market ID code of the member/participant/user firm; the clients could also use the trading infra-structure of the member/participant/user or not (this last case is called Sponsored Access (SA)).

The DEA provider firm has the ultimate responsibility for their trades and not the venue and should have adequate systems to minimize the risk of their clients disrupting orderly trading or participating in market abuse activities even before permission to provide DEA services is given. The venues should retain the right to decide who is able to access its markets and which clients could use the SA; for proper order management, venues should be able to distinguish between the orders sent from SA users from other orders.

Investment firms should: determine, according to previously defined criteria, which clients could use DEA and it is recommended to have a written basic agreement (similar to the firm-retail client in MiFID) between provider and DEA clients (although they are more likely to be professionals); have pre-trade controls that stop automatically any order from a DEA client which would either compromise the DEA provider firm's risk appetite or the credit thresholds, and in case of SA, this control would need to be done at the venue level; monitor post-trade using clients ID to review their trading activity and access to the order, through firms controls or, in SA, the client's controls or controls purchased from a vendor (outsourcing).

Guidelines on clearing by investment firms.

Investment firms, to control the risks of acting as a general clearing member, should: assess its clients (credit strength, internal risk controls, trading strategy); set appropriate trading/position limits to manage its own clearing risk; and monitor the positions of the clients and the risk taking into account margin calls on an intraday basis from the clearing house.

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