

The Investment Association

Association for Financial Markets in Europe

EEA Electronic Trading Systems and Controls Statement

A. PREAMBLE

- This Electronic Trading Systems and Controls Statement ('Statement') is based on a template that has been created through the collaborative effort of the members of The Investment Association (TIA) and the Association for Financial Markets in Europe (AFME) (together, 'Associations'). The template is to remain subject to an ongoing review process to keep it updated and fit for purpose
- Version of the template used for this Statement: v 1.0, 28 January 2016
- The scope of the Statement is defined in point 1 of Part B
- The Statement refers to the ESMA Guidelines on Systems and Controls in an Automated Trading Environment for Trading Platforms, Investment Firms and Competent Authorities¹ ('ESMA Systems and Controls Guideline') which apply to investment firms (Guidelines 2, 4, 6 and 8)
- The information provided in this Statement is strictly confidential and for the benefit of the recipient firm and its affiliates only
- The information is valid at the point in time when it is provided
- The liability regime for the information provided in this Statement is established by the Disclaimer included in the box at the end of this paragraph, which is provided by the responding electronic trading service provider. Neither Association makes any representation or warranty, express or implied, in relation to the Statement, including without limitation as to its suitability, completeness or fitness for purpose. Under no circumstances shall either of the Associations be liable for any loss or damage, whether direct or indirect, arising out of or in connection with the use of this Questionnaire

Disclaimer

[Service provider's disclaimer]

¹ ESMA Guidelines: Systems and Controls in an Automated Trading Environment for Trading Platforms, Investment Firms and Competent Authorities: http://www.esma.europa.eu/system/files/esma_2012_122_en.pdf

B. STATEMENT

1. The information included in this Statement relates to the electronic systems and controls of the following entities:

- *[to be completed (e.g. Firm A Company 1)]*
- *[to be completed (e.g. Firm A Company 2)]*
- *[...]*

and covers the following products

- *[to be completed (e.g. cash equity)]*
- *[to be completed]*
- *[...]*

2. We are an [investment firm] regulated by [the FCA], and to the extent that we handle your orders, we have in our reasonable knowledge and belief, implemented systems and controls designed to comply with controls required of an investment firm pursuant to the ESMA Systems and Controls Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities.

To the extent that we use third parties for electronic execution of your orders, we have processes in place to monitor our use of them.

We advise of the following comments in relation to the ESMA Systems and Controls Guidelines which are reported in the Annexes (Section C):

[Please include any comments in relation to the provisions of the Guidelines that you may have]

C. ANNEXES

ANNEX I – GUIDELINE 2: ORGANISATIONAL REQUIREMENTS FOR INVESTMENT FIRMS’ ELECTRONIC TRADING SYSTEMS (INCLUDING TRADING ALGORITHMS)

| CHAPTER | GUIDELINES TEXT |
|----------------------------|--|
| a) Governance | <p>The governance process is central to compliance with regulatory obligations. Investment firms should, within their overall governance and decision-making framework, develop, procure (including outsourcing) and monitor their electronic trading systems, including trading algorithms, through a clear and formalised governance process.</p> <p>This governance process must ensure that all of the relevant considerations including commercial, technical, risk and compliance that ought to be brought to bear in making the key decisions are given due weight. In particular, it must embed compliance and risk management principles.</p> <p>The governance process must also have clear lines of accountability, including procedures for the sign-off for development, initial deployment, subsequent updates and resolution of problems identified through monitoring. There should also be appropriate procedures for the communication of information.</p> |
| | <p>In the governance process compliance staff should be responsible for providing clarity about the firm’s regulatory obligations and the policies and procedures that seek to ensure the use of the trading systems and algorithms comply with the firm’s obligations and that any failures to comply are detected. This means compliance staff needs to understand the way in which trading systems and algorithms operate, but not knowledge of the technical properties of the trading systems or algorithms.</p> |
| b) Capacity and resilience | <p>Investment firm’s electronic trading systems should have sufficient capacity to accommodate reasonably foreseeable volumes of messaging. Capacity should be scalable and able to respond to rising message flow and emergency conditions that might threaten the system’s proper operation.</p> |
| c) Business Continuity | <p>Investment firms should have adequate, reasonable and effective business continuity arrangements in relation to their electronic trading systems to cover disruptive incidents (which, as necessary, can ensure a timely resumption of trading) including but not limited to system failures, as the arrangements should cover, as appropriate, matters such as:</p> <ul style="list-style-type: none"> a) Governance for the development and deployment of the arrangements; b) Consideration of an adequate range of possible scenarios related to the operation of their electronic trading systems which require specific continuity arrangements; c) The backing up of business (including compliance) critical data that flows through their electronic trading systems; d) The procedures for moving to and operating the electronic trading system from a back-up site; e) Staff training on the operation of the arrangements and individuals’ roles within them; and f) An on-going 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. |

| CHAPTER | GUIDELINES TEXT |
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| d) Testing | <p>Investment firms should 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. For algorithms these might include performance simulations/back testing or offline testing within a trading platform testing environment (where market operators make testing available).</p> |
| | <p>The use of these methodologies should 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 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. Working effectively in stressed market conditions may imply (but not necessarily) that the system or algorithm switches off under those conditions.</p> |
| | <p>Investment firms should 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). The investment firm should also ensure these tests are commensurate with the risks that this strategy may pose to itself and to the fair and orderly functioning of the markets operated by the trading platforms the firm intends the algorithm to send orders to. Investment firms should undertake further testing if the markets in which the algorithm is to be used changes from those originally intended.</p> |
| | <p>Investment firms should roll out the deployment of trading algorithms in a live environment in a controlled and cautious fashion by, for example, limits being placed on the number of financial instruments being traded, the value and number of orders, and the number of markets to which orders are sent to enable the firm to check that an algorithm performs as expected in a live environment and to make changes if it does not.</p> |
| e) Monitoring and review | <p>Investment firms should monitor in real time their electronic trading systems, including trading algorithms. They should deal adequately with problems identified as soon as reasonably possible in order of priority and be able when necessary to adjust, wind down, or shut down the electronic trading system. Investment firm, when taking action to deal with problems with electronic their trading systems should take due account of the need, as far as possible, for members/participants and users of regulated markets to act in an orderly manner.</p> |
| | <p>Investment firms should periodically review and evaluate their electronic trading systems and trading algorithms, and the associated governance, accountability and sign-off framework and associated business continuity arrangements. They should act on the basis of these reviews and evaluations to remedy deficiencies identified. The review and evaluation process should have some degree of independence which can be achieved, for example, by the involvement of internal audit or third parties.</p> |
| | <p>Reviews of the performance of trading algorithms should include an assessment of the impact on market integrity and resilience as well as profit and loss of the strategies the algorithm is deployed for.</p> |

| CHAPTER | GUIDELINES TEXT |
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| f) Security | Investment firms should have procedures and arrangements for physical and electronic security designed to protect their 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. |
| g) Staffing | Investment firms should have procedures and arrangements, including training and recruitment, to determine their staffing requirements and to employ sufficient number of staff with the necessary skills and expertise to manage their electronic trading systems and trading algorithms. This will include employing staff who have knowledge of relevant electronic trading systems and algorithms, the monitoring and testing of such systems and algorithms, and of the sort of trading strategies that the firm deploys through its trading systems and algorithms and of firms' regulatory obligations. |
| h) Record keeping and cooperation | Investment firms should keep, for at least five years, records of their electronic trading systems (and trading algorithms) in relation to the matters covered in paragraph 3, including information about key decisions, the trading strategy or strategies that each algorithm is deployed to execute, system properties, testing methodologies, test results and periodic reviews. The records should be sufficiently detailed to enable competent authorities to monitor firms' compliance with their relevant obligations. |
| | Investment firms should inform competent authorities, in line with supervisory arrangements in that exist in their home Member State, about any significant risks that may affect the sound management of the technical operations of their electronic trading systems and algorithms and major incidents where those risks crystallise. |

ANNEX II – GUIDELINE 4: ORGANISATIONAL REQUIREMENTS FOR INVESTMENT FIRMS TO PROMOTE FAIR AND ORDERLY TRADING IN AN AUTOMATED TRADING ENVIRONMENT

| CHAPTER | GUIDELINES TEXT |
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| a) Price or size parameters | Investment firms should be able to automatically block or cancel orders that do not meet set price or size parameters (differentiated as necessary for different financial instruments), either or both on an order-by-order basis or over a specified period of time. |
| b) Permission to trade | Investment firms should be able to automatically block or cancel orders from a trader if they are aware for a financial instrument that a trader does not have permission to trade. |
| c) Risk management | Investment firms should be able to automatically block or cancel orders where they risk compromising the firm’s own risk management thresholds. Controls should be 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. |
| d) Consistency with the regulatory and legal framework | The electronic systems of investment firms, and the orders these generate, should be consistent with the firm’s obligations under MiFID, 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). |
| e) Reporting obligations to supervisory arrangements | Investment firms should inform competent authorities, in line with the supervisory arrangements that exist in their Member State, about significant risks that may affect fair and orderly trading and major incidents where those risks crystallise. |
| f) Overriding of pre-trade controls | 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 aware of when controls are being overridden and require their approval for the overriding of these controls. |
| g) Training on order entry procedures | Investment firms should ensure that employees involved in order entry have adequate training on order entry procedures, for example through on-the-job training with experienced traders or classroom-based training, including complying with requirements imposed by trading platforms, before they are allowed to use order entry systems. |
| h) Monitoring and accessibility of knowledgeable and mandated staff | Investment firms should, during the hours they are sending orders to trading platforms, monitor their orders in as close to real time as possible, including from a cross-market perspective, for potential signs of disorderly trading. This monitoring should be conducted by staff who understand the firm’s trading flow. These staff members should be accessible to the firm’s home competent authority and to the trading platforms on which the firm is active and should have the authority to take remedial action, when necessary. |
| i) Close scrutiny by compliance staff | Investment firms should ensure that compliance staff are able to follow closely the firm’s electronic trading activity so that they can quickly respond to and correct any failures or regulatory infractions that may take place. |

| CHAPTER | GUIDELINES TEXT |
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| j) Control of messaging traffic | Investment firms should ensure that they have control of messaging traffic to individual trading platforms. |
| k) Management of operational risk | Investment firms should manage the operational risks in electronic trading through appropriate and proportionate governance arrangements, internal controls and internal reporting systems taking account, as appropriate, of CEBS' Guidelines on the Management of Operational Risk in Market-Related Activities. |
| l) IT compatibility | Investment firms should ensure that the systems that that they use to access a trading platform have a minimum level of functionality that is compatible with the trading platform's electronic trading systems and will not pose a threat to fair and orderly trading on that platform. |
| m) Record keeping and co-operation | i) Investment firms should keep records, for at least five years, of the matters covered by points a) to l) above. The records should be sufficiently detailed to enable competent authorities to monitor firms' compliance with their relevant obligations. |
| | ii) Investment firms should inform competent authorities, in line with the supervisory arrangements that exist in their Member State, about significant risks that may affect fair and orderly trading and major incidents where those risks crystallise. |

ANNEX III – GUIDELINE 6: ORGANISATIONAL REQUIREMENTS FOR INVESTMENT FIRMS TO PREVENT MARKET ABUSE (IN PARTICULAR MARKET MANIPULATION) IN AN AUTOMATED TRADING ENVIRONMENT

| CHAPTER | GUIDELINES TEXT |
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| a) Understanding, skill and authority of compliance staff | Investment firms should have procedures to seek to ensure that staff exercising the compliance function has sufficient understanding (of both regulation and trading activity), skill and authority to challenge staff responsible for trading when the trading activity gives rise to suspicions of market abuse (in particular market manipulation). |
| b) Training in market abuse | Investment firms should provide 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. |
| c) Monitoring activity | Investment firms should monitor 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. This should involve having 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), including (where the firm has sight of this) cross-market behaviour. |
| d) Arrangements for the identification and reporting of suspicious transactions and orders | Investment firms should have arrangements to identify transactions, and it is recommended that these arrangements also cover orders, that require a STR to competent authorities in relation to market abuse (in particular market manipulation) and to make those reports without delay (if initial enquiries are undertaken, a report should be made as soon as possible if those enquiries fail to find a satisfactory explanation for the observed behaviour). |
| e) Periodic reviews and internal audits of compliance arrangements and procedures | Investment firms should conduct periodic reviews and internal audits of procedures and arrangements to prevent and identify instances of conduct that may involve market abuse. |
| f) Frequently reviewed arrangements governing the access of staff to trading systems. | Investment firms should keep, for at least 5 years, records of the arrangements and procedures to identify conduct that may involve market abuse covering the matters set out in points a) to e) above, including an effective audit regarding how each alert of possible suspicious behaviour is dealt with whether or not a report is made to the relevant competent authorities. These records should be sufficiently detailed to enable competent authorities to monitor firms' compliance with their relevant obligations. |

ANNEX IV – GUIDELINE 8: ORGANISATIONAL REQUIREMENTS FOR INVESTMENT FIRMS THAT PROVIDE DIRECT MARKET ACCESS AND/OR SPONSORED ACCESS

| CHAPTER | GUIDELINES TEXT |
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| a) Due diligence on direct market access/sponsored access clients | Investment firms must conduct due diligence on prospective DMA/SA clients, as appropriate to the risks posed by the nature of the clients, the scale and complexity of their prospective trading activities and the service being provided. Due diligence might, as appropriate, cover matters such as the training and competency of individuals entering orders, access controls over order entry, allocation of responsibility for dealing with actions and errors, the historical trading pattern/behaviour of the client (when available), and the ability of clients to meet their financial obligations to the firm. In the process of due diligence investment firms can take into account whether the prospective client is regulated under a directive, the national law of a Member State or under the law of a third country and their disciplinary history with competent authorities and trading platforms. The due diligence assessment should be periodically reviewed. |
| b) Pre-trade controls | <p>i. Pre-trade controls on the orders of DMA/SA clients of the sort covered in paragraph 2 of Guideline 4 on organisational requirements for investment firms to promote fair and orderly trading in an automated trading environment, including in-built and automatic rejection of orders outside of certain parameters.</p> <p>ii. There should be absolute clarity that the investment firm should solely be entitled to modify the parameters of the pre-trade controls (i.e. the DMA/SA client should not be able to do so).</p> <p>iii. Investment firms offering DMA/SA 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 platform itself (i.e. 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.</p> |
| c) 'Naked' or 'unfiltered' market access | 'Naked' or 'unfiltered' access to a regulated market or MTF, where a client's orders do not pass through pre-trade controls before being sent to a regulated market or MTF, is prohibited under MiFID. Therefore, an SA client should never be able to send an order to a trading platform without the order passing through pre-trade controls of the investment firm. |
| d) Monitoring | <p>i. The monitoring of orders (including on a cross-market basis) that investment firms are required to carry out under guideline 4 should apply to all order flow including that from DMA/SA clients, and likewise the systems that investment firms are required to have under guideline 6 for identifying possible instances of market abuse (in particular market manipulation) should apply to orders from and transactions by DMA/SA clients.</p> <p>ii. To comply with these obligations investment firms will need to be able to separately identify orders and transactions of DMA/SA clients from other orders and transactions of the firm.</p> <p>iii. Investment firms should also have the ability to immediately halt trading by individual direct market access/sponsored access clients.</p> |
| e) Rights and obligations of the parties | Investment firms should establish clarity about the rights and obligations of both parties in relation to the DMA/SA service. |

| CHAPTER | GUIDELINES TEXT |
|-------------------|---|
| f) Record keeping | Investment firms should keep, for at least five years, records of the matters covered in points a) to e) above that are sufficiently detailed for competent authorities to monitor firms' compliance with their relevant obligations. This should include at least the results of due diligence carried out on potential direct market access/sponsored access clients and subsequent reviews, and the rights and obligations of both parties in relation to the direct market access/sponsored access service. |