

ESMA Guidelines

on systems and controls in an automated trading environment

May 2012

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Fidessa
Trade / Invest / Inform

ESMA Guidelines – Turn change into opportunity

Guidelines to foster EU convergence in supervisory practices regarding automated trading and to help in providing a level-playing-field to investors



- Guidelines to harmonise regulatory expectations across the EU
- As best practice evolves, adjust your plans to ensure on-going compliance
- Active industry discussion

ESMA Guidelines impact a wide range of areas

Scope

- Current MiFID and MAD - any financial instrument
- Operation of an electronic trading system by a Regulated Market or MTF
- Use of an electronic trading system, including a trading algorithm, by an investment firm on own account or on behalf of clients
- Provision of direct market access or sponsored access by an investment firm as part of the service of the execution of orders for clients
- Cross-market and multi-asset coverage

MiFID timeline confirms industry faces a huge challenge



- **Dec 2010:** European Commission (EC) published the Review of MiFID consultation document in Dec 2010
- **Feb 2011:** Consultation closed
- **October 2011:** EC presented MiFID and MiFIR to the European Parliament (EP)
- **Start 2012 – Currently in review stage (EP/Council/Member states/Debate in EP)**
 - Rapporteur Markus Ferber proposed amendments March
 - All other MEP amendments tabled by 10 May, committee vote early July
- **During 2012:** ESMA Guidelines to reinforce existing MiFID
 - ...on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities apply as of 1st May 2012 (or a plan in place)
- **End 2012:** (tbc) agreement on final text (Level 1) – legislation will enter into force
- **2013/14:** (tbc) ESMA development of binding technical standards (Level 2 detail) to support MiFID II
- **Mid 2015:** (tbc) MiFID II live date – 30 months from entry into force, some regulation will apply earlier

ESMA Guidelines Cover a number of Key Themes

Key Themes

- 1 Clear, formalised **Governance**
- 2 Effective **Training** to maintain competency
- 3 Controlled Management of **Risk**
- 4 **Monitoring** of trading activity
- 5 Managing **Automated Trading**
- 6 System **Capacity, Resilience** and **Business Continuity Planning**
- 7 **Record Keeping** and **Periodic Review**, audit trails

1 Governance

ESMA Guidelines

Organisational obligations on a firm to have a clear and formalised governance process

- Focus on policies and procedures
- Adequate resourcing levels - clearly defined roles and responsibilities
- Due diligence, documentation, change control, audit trails
- Clearly defined system development and testing methodologies
- Accountability, responsibility, effective communication
- Record Keeping
- Periodic Review

Fidessa Delivers...

- ✓ Fidessa obtains an annual SSAE 16 and ISAE 3402 Type II report issued by an independent audit firm. The scope covers the IT and operational controls over the provision of our Hosted Products and Services
- ✓ Fidessa is certified to ISO 9001:2008 (TickIT) standard. Internationally recognised quality standard for businesses, and our certification demonstrates our commitment to providing quality products and services to our customers
- ✓ Fidessa's Quality Management System (QMS) addresses the design, development, production, installation, and servicing of our products and services
- ✓ Fidessa continually reviews and improves its processes

2 Training

ESMA Guidelines

A focus on training and competency

- Procedures to ensure staff (and clients) have sufficient competency, skill and authority to perform their role
- Order entry – adequate training
- Compliance team - ensure that compliance staff are properly trained and up to date with latest market developments (regulation, trading activity, MAD)
- DMA Clients (and SA) - develop training materials for clients as part of due diligence process
- Keep Training Records, evidence of competency
- Periodic Review

Fidessa Delivers...

- ✓ Functional demos
- ✓ Client Relations Team training staff at customer sites
- ✓ One-to-one, small group and classroom training, workshops, upgrade support
- ✓ Training materials for new clients
- ✓ Client site, WebEx, Classroom
- ✓ Tailored training
- ✓ Train the Trainer
- ✓ Fidessa offers a full range of training courses covering all aspects of our product sets
- ✓ In-house regulation education (ESMA, MiFID, MAD)

3 Risk Management

ESMA Guidelines

A focus on adequate pre-trade risk controls

- No naked Sponsored Access - pre-trade risk controls controlled by the firm, no client access to pre-trade risk controls
- Pre-trade controls, client limits
- Max order size and price deviation limits
- Control of messaging traffic to individual trading platforms
- Authorised trader access to trade, registered traders
- Documentation, change control, authorisation procedures
- Record Keeping
- Periodic Review

Fidessa Delivers...

- ✓ Only permissioned users can set limits
- ✓ Pre-trade counterparty consideration limits
- ✓ Order validation (system and user group) checking price and size against Exchange published thresholds
- ✓ Two Tier Risk Administration for F&O (customer and client)
 - ✓ Maximum Order Size
 - ✓ Price Deviation
 - ✓ Enable/Disable Trading
 - ✓ Maximum Position (Long/Short)
- ✓ Fidessa market access components pass conformance on each individual exchange
- ✓ User permissions and authenticated password control
- ✓ Full Audit Trail

4a Monitoring Activity

ESMA Guidelines

Firms should monitor activities of own traders/algos and activities of their clients

- All orders, fills, amendments and cancellations
- A focus on Automated Trading
- Adequate systems in place to flag suspicious behaviour
- Separately identify DMA/SA client order flow with the ability to halt trading
- Review your existing Suspicious Transaction Reports process
- Roles and responsibilities - accessible to the firm's home competent authority
- Documentation and procedures
- Periodic Review

Fidessa Delivers...

- ✓ Fidessa functionality supports user real-time monitoring of positions and live orders as well as pulling orders, individually or en masse
- ✓ Fidessa Checks and Monitoring
 - ✓ Daily System checks
 - ✓ Monitoring of Hosted Systems
- ✓ Full Audit Trails (real-time and end of day)
- ✓ MIS Reporting
- ✓ The Fidessa Support Help Desk is available throughout the day

4b Monitoring Activity

ESMA Guidelines

Potential cases of market manipulation that could be of concern

- **Ping orders** – entering small orders in order to ascertain the level of hidden orders and particularly used to assess what is resting on a dark platform.
- **Quote stuffing**- entering large numbers of orders and/or cancellations/updates to orders so as to create uncertainty for other participants, slowing down their process and to camouflage their own strategy.
- **Momentum ignition**- entry of orders or a series of orders intended to start or exacerbate a trend, and to encourage other participants to accelerate or extend the trend in order to create an opportunity to unwind/open a position at a favourable price
- **Layering and Spoofing**- submitting multiple orders often away from the touch on one side of the order book with the intention of executing a trade on the other side of the order book. Once that trade has taken place, the manipulative orders will be removed.

Fidessa Delivers...

- ✓ Depending on customer requirements manual monitoring of activity can be achieved for
 - ✓ Insider dealing checks
 - ✓ DMA market abuse
 - ✓ Principal dealing checks
- ✓ Ability to deploy Market Abuse Monitoring tools
- ✓ Real-time order event stream to firm's external surveillance system

5 Automated Trading

ESMA Guidelines

A focus on appropriate governance process to manage automated trading

- Document all algos/synthetic order types/spreader - parameters and behaviour e.g. scenarios where an algo should withdraw and suspend from being active on the market
- Document testing methodology, tests plans
- Ensure that an audit trail of testing results are captured with formal sign-off and change control procedure is in place
- Ensure that users/support of algos have access to tools and are properly trained to pro-actively monitor algos
- Periodic Review

Fidessa Delivers...

- ✓ Fidessa Functional Descriptions
- ✓ Fidessa provides release notes for all new releases
- ✓ Fidessa conducts testing of any new Release prior to release to the Customer and in accordance with the current ISO 9001:2008 policies and procedures
- ✓ Customers should also perform their own User Acceptance Testing prior to a new release going live

6a Capacity, Resilience and Business Continuity Planning

ESMA Guidelines

A focus on sufficient system capacity and scalability

- Ensure that sufficient capacity monitoring / planning processes are in place for all trading platforms
- Alert thresholds and escalation process
- Documentation, policies, procedures
- Periodic review

Fidessa Delivers...

- ✓ Fidessa manages the infrastructure for 100+ customers with capacity scaled according to their individual trading requirements
- ✓ Capacity utilisation on each customer's trading platform is monitored individually e.g. CPU, disk space, communication lines, memory
- ✓ Any alert raised is analysed and managed as required by the individual circumstances

6b Capacity, Resilience and Business Continuity Planning

ESMA Guidelines

A focus on adequate business continuity arrangements

- Formally document BCP recovery plan
- Ensure that the relevant SLAs are documented
- Training
- Good communication
- Dress rehearsals for BCP and follow-up action plans
- Periodic Review

Fidessa Delivers...

- ✓ Fidessa operates on a primary and "hot" standby configuration distributed over diverse hardware. If the primary system fails the hot standby takes over with little or no disruption of service and no loss of data
- ✓ Dedicated connectivity is implemented, maintained and supported by Fidessa. Where possible, the network is implemented using dual connections each of which is provided by different telecommunication companies using diverse routing. Each connection is terminated on the Customer's site using a separate router. The routers are configured to provide fast failover in case of a fault on one of the communication lines
- ✓ Fidessa performs quarterly BCP tests within the organisation targeting specific areas on a rotational basis

7 Record Keeping and Periodic Review

ESMA Guidelines

A focus on sufficiently detailed record keeping to monitor firms' compliance

- Investment firms should keep, for at least 5 years, records of their electronic trading systems (and trading algorithms)
- Including information about key decisions, the trading strategy or strategies that each algorithm is deployed to execute, system properties, user access, testing methodologies, test results and periodic reviews
- Ensure that all business critical and compliance records are backed up for a minimum of 5 years
- Periodic Review

Fidessa Delivers...

- ✓ A yearly backup is taken (on the first Friday in January) with 5 year retention.
- ✓ A rolling transaction history of up to three months is maintained within the Fidessa real-time database and is available for queries via FTW
- ✓ A data archiving process runs daily which removes all trade and order records greater than three months old that have been fully booked or cancelled
- ✓ Fidessa provides a set of standard daily MIS reports to enable Customers to take data from Fidessa for storage, analysis and resolution of queries
- ✓ All Customer dedicated servers will be included within the Fidessa backup process. The backup includes Fidessa data and application software.

And also...

Potential in the future for

- EU harmonised pre and post trade controls
- Single EU tick size
- Constraints on order flow speed
- Consistency and greater harmonisation with US and globally

Trust Fidessa to guide you through change