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**Nordic Securities Association<sup>1</sup> (NSA) views on:  
Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities**

The Nordic Securities Association (“NSA”) represents the common interests of Member firms in the Nordic securities dealers associations towards external stakeholders primarily in the Nordic market but also on European and international issues of common interest. We believe in fair, orderly and competitive markets.

General Comments

- NSA supports the objective of the ESMA proposal to address challenges of a highly automated trading environment, by seeking to clarify the obligations of trading platforms and investment firms under the existing EU legislative framework, thereby harmonising and potentially enhancing systems and controls in such a highly automated trading environment. However, NSA’s support for the introduction of the guidelines is subject to ESMA ensuring that the guidelines are implemented in a harmonised manner across Europe; that NSA’s material concerns regarding the suggested guidelines, in particular e.g. guideline 4, no. 2, 2<sup>nd</sup> dash and guideline 4, no. 5, are taken into account; and that ESMA addresses the gap concerning unregulated firms trading directly on execution venues while not directly being affected by these suggested guidelines. .
- In addition, NSA takes the opportunity to express our overall concerns regarding trading in equities. As we have all observed, the introduction of MiFID has significantly changed the trading landscape

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<sup>1</sup> The Nordic Securities Association (NSA) represents the common interests of member firms in the Nordic securities dealers associations towards external stakeholders primarily in the Nordic market but also on European and international issues of common interest. Members of the NSA are the Danish Securities Dealers Association, the Finnish Federation of Financial Services, the Norwegian Securities Dealers Association and the Swedish Securities Dealers Association.

across Europe due to the competitive environment. The increased numbers of trading venues has led to an aggressive competition for attracting liquidity and volume, and we have seen adverse consequences:

- **Fragmented trading:** The trading in equities is fragmented and spread on a number of trading venues, BCNs and dark pools.
  - **Challenged price discovery and best execution:** In fragmented markets there is a best execution requirement to access all relevant execution venues. However, not all venues (e.g. BCNs') are accessible for all investment firms, which compromise efficient price discovery and obtainment of best execution.
  - **Increased market impact:** Low tick sizes combined with Round Lot down to 1 share in the lit markets are some of the factors resulting in a further reduction in average order sizes, reduced depth on each price level and thereby increased market impact compared with the situation a couple of years ago.
  - **Increased costs:** Access to various venues implies increased costs for e.g. connectivity to each venue, access to a smart order router, relevant order functionality, a requirement to obtain market data from all venues, all resulting in updated hardware and software requirements, and potentially higher trading and clearing costs (depending on whether the execution venues', CSDs', CCPs' and clearing firms' costs are based on volume or per-order/-trade based). Moreover, there is a continuous requirement to have fast computers and access to co-location to be able to use the low latency at the trading venues at all times. Thus, the investment firms have already made significant investments in the new trading landscape and regulators need to be careful in not introducing any further burdens that do not address the problem.
  - **Challenged IT-capacity:** Increased use of High Frequency (HF) orders due to low tick sizes and lot sizes challenges the IT-capacity overall. HF orders tend to be smaller in size but substantial in numbers.
- Thus, NSA reiterates the value of reviewing in particular the tick size issue, but also the need for non-discriminatory access to co-location on reasonable commercial terms.
  - A substantial part of HFT is done by so-called unregulated firms, which either trade directly on the venue or via Sponsored Access. NSA regards it necessary that all members of a trading venue should

be regulated on equal terms and placed under supervision by the financial supervisory authorities giving surveillance and competition on equal conditions. As present legislation does not cover trading participants that are not investment firms, NSA proposes that ESMA proposes other measures to solve this gap, e.g. by directing all trading platforms to maintain the same requirements towards all trading participants as set out in these guidelines.

- NSA stresses the need for a clearer and better framework for what can be regarded as market abuse and not. In case of market abusive behaviour this should be sanctioned effectively. In awaiting the revised Market Abuse framework, it would be of much value if the guidelines could be clarified further and being applied harmonised across Europe (and globally).
- NSA stresses the need for better conditions for the market surveillance departments that currently do not have the whole picture due to fragmented markets.
- Rules and regulations should be proportionate and thus adapted for the kind of activities conducted by the market/participant and thereby not making the requirements too heavy for any small market/participant not operating or facilitating HFT.

Detailed Comments to the questions:

1. **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?**

Yes, we support the proposal which will give better conditions for a level playing field for the market participants until MiFID is revised. Moreover, we see a need to introduce appropriate guidelines on system and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities.

However, it is as important that guidelines are introduced and implemented in a harmonised way throughout the whole EU/EES area. ESMA should as well be mindful of the above-mentioned general comments, ensuring that the guidelines only clarify existing legislation and do not introduce any new obligations on participants other than those based on existing legislation. Those guidelines that cannot be implemented in a harmonised way throughout Europe should wait for MiFID II.

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

Yes.

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

No.

4. **Do you have additional comments on the draft guidelines on organizational requirements for trading platforms' electronic trading systems?**

When considering guidelines it is as important to define which activities are meant and what the guidelines should cover. NSA proposes ESMA to define the area. Algorithmic trading is now defined in article 4 paragraph 1 subparagraph 35 of the MiFID draft and the EC refers to HFT in paragraph 46 of the recital to MiFID II. However, since these guidelines are planned to come out before MiFID II, it would be preferred with clearer definition on what areas are covered by these guidelines.

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

Yes.

6. **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?**

There have lately been discussions regarding the need for additional information in automated orders making it easier for the market surveillance and competent authorities to analyse orders. For example: information if the order is an algo-order or a prop-order, who is responsible for the order or the programming? NSA is not sure if this additional information is necessary. However further evaluation would be of interest.

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

systems?

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Yes. NSA notes that ESMA is proposing guidelines for investment firms' electronic trading systems that only concern investment firms and not RM and MTF. NSA question why such differences have been drawn between market operators' and investment firms' respective potential obligations.

**8. 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?**

Yes, however

- a. Re. guideline 3, no. 2, 1<sup>st</sup> dash. The ability to "cancel, amend or correct a transaction" should always be in accordance with the rules of the trading platform in order to maintain reasonable predictability.
- b. Re. guideline 3, no. 2, 2<sup>nd</sup> and 3<sup>rd</sup> dash: It is not a proper method to have capacity limits/flow limitations. This would imply many questions, such as: Which client's order should be stopped or delayed? Or should a member with a large market share at the trading venue suddenly have the same limit as a small member, giving clients at the small member advantages in a turbulent market when massive orders are sent to the trading venue? For these circumstances we propose that the trading venue solves the challenge with a proper pricing of its services.
- c. Re. guideline 3, no. 2, 4<sup>th</sup> dash: We support the introduction of circuit breakers or similar price deviation limits. However, it would be of further benefit if these arrangements to halt trading and decisions to halt trading were further harmonised and mandatory throughout all trading venues in Europe to avoid competition between trading venues and increase the awareness and understanding of end-customers.
- d. Re. guideline 3, no. 2, 6<sup>th</sup> dash: We support requirements for members' and participants' pre- and post-trade controls. However, cf guideline 4. In order to create a level playing field between investment firms and other participants of a trading platform, any requirements maintained against investment firms in guideline 4 should be reflected herein, thus requiring trading platforms to maintain these minimum requirements against all members and participants.

- e. Re. guideline 3, no. 2, last dash: Regarding the proposal 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” it is our understanding that the competition between the trading venues may prove this difficult in practice. We propose that the unbiased authorities are best to collect this information.

**9. 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?**

See answers to Q8 above

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

See answers to Q8 above

**11. 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?**

Re. guideline 4, no. 2, 2<sup>nd</sup> dash. It is in practice not possible to have pre trade controls linked to client’s verified holdings or cash. Legitimate trading controls, that adequately handle such situations, already exist. On the one hand, trading platforms already require the executing trading participant to be responsible for the orders and trades, and the trading participants to manage such obligations with appropriate lending arrangements, if required, and, on the other hand, the trading participants always forwarding such delivery, lending and other obligations to the client, in combination with relevant risk controls, such as daily trading limits appropriately set for each client, monitoring tools, etc. A requirement to check this in advance will hamper the clients' integrity, does not fit to the infrastructure in foreign countries and will be a breach of law in several countries. Further, the implementation of pre trade controls linked to client’s holdings or cash would further call into question legitimate short selling strategies. Thus, suggested guideline needs to be deleted in its entirety and to be addressed in the parallel short selling consultations.

it could further be noted that in case holdings or cash would need to be verified before an order is transmitted to the trading venue, the

latency for that any order executed by an investment firm on behalf of a client will as well always be longer than the instant order from the HFT firm trading on its own account, implying that every single client order, independent of how sophisticated and fast trading systems the investment firm otherwise has invested in, will always be slower than any principal order, thereby losing opportunities available only to principal orders.

Regarding guideline 4, no. 5, the proposal that “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” is too ambitious. Sometimes there could be thousands or more of orders per second it is neither realistic nor efficient to look at every single order at the moment when the order is transmitted to the trading venue. The compliance tools currently available, independent of how sophisticated their analysis tools are preset, normally process available information overnight, then providing a number of examples which requires further investigation based on current circumstances. The most important issue must be to check behaviours and in case there are any questions, to double-check it..

Re. guideline 6: What is said about “Investment firms should ensure that they have control of messaging traffic to individual trading platforms to avoid overcrowding the systems of the trading platform” is unclear to us. Does it mean that the investment firm should limit its orders to avoid overcrowding if a competing firm sends a lot of orders? In this case we refer to the answer to Q8 above.

- 12. 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?**

See answers to Q11 above

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

See answers to Q11 above

- 14. 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?**

NSA regards necessary that the guidelines regarding market abuse becomes more detailed and explain what is market abuse (in a highly

automated electronic trading environment). The description must be more specific. It must be explained what kind of behaviour is accepted and what is not accepted. The rules must also be totally harmonised throughout Europe and between different trading venues. It cannot be accepted that the rules are interpreted differently in different parts of Europe. Euronext informed the market participants already two years ago about behaviours that could be market abuse. Order layering and spoofing were mentioned and technical surveillance systems were recommended in the case you had these clients. There are some examples in the consultation paper that can be developed further to clarify what is market abuse.

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

See answer to Q 14 above.

**16. 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?**

See answer to Q 14 above.

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

See answer to Q 14 above. In addition, STRs should be limited to transactions, and not include orders.

**18. 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?**

A substantial part of HFT is done by so-called unregulated firm, which either trade directly on the venue or via Sponsored Access. It is our view that all firms that are direct members of a trading platform should generally be regulated as investment firms with exemptions for e.g. corporate treasurers and commodities firms, whose market activity is linked to their commercial activities.

This include the HFT firms of a certain size which, due to their impact on the market and pricing, have access through sponsored access or via investment firms. NSA cannot see any reasons why these HFT

firms would have lower requirements (and lower costs) on their activities than investment firms. NSA proposes that ESMA solve this by directing all trading platforms to maintain the same requirements as set forth in these guidelines towards all trading participants.

19. **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?**  
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20. **Do you have additional comments on the draft guidelines relating to organizational requirements for trading platforms whose members/participants or users provide DMA/SA?**  
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21. **Do the draft guidelines on organisational requirements for investment firms providing DMA/SA deal adequately with the differences between DMA and SA?**  
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22. **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?**  
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23. **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?**  
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24. **Do you have additional comments on the draft guidelines on organizational requirements for investment firms providing DMA/SA?**

As stated and explained above, in answer to Q11, NSA opposes man-

datory measures to check whether clients have cash or securities when transmitting orders to trading venues

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- 25. 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?**

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