

The Guideline below is being re issued as Circular C029 for correct filing purposes



## **Guidelines GD-IF- 05**

### **Guidelines on systems and controls in an automated trading environment for trading platforms and Cyprus Investment Firms (CIF)**

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## I. INTRODUCTION – RELEVANT LEGISLATION

1. These guidelines refer to the systems and controls in an automated trading environment for trading platforms and CIF.
2. For ease of reference, all the relevant, with these guidelines, provisions of the Investment Services and Activities and Regulated Markets Law (**‘the Law’**), of the Directive DI144-2007-01 of 2012 of the Cyprus Securities and Exchange Commission for the authorisation and operating conditions of the Cyprus Investment Firms (**‘the Directive’**) and of the Insider Dealing Market and Manipulation (Market Abuse) Law, are included in the Appendix.

## II. DEFINITIONS

3. For the purpose of this paper, the following terms have the same meaning as the definition given below. Terms used in these guidelines that are not interpreted differently shall have the meaning given to them by the Law.

«*Trading Algorithm*» means computer software operating on the basis of key parameters set by a CIF or a client of the CIF that generates orders to be submitted to trading platforms automatically in response to market information.

«*Direct Market Access (DMA)*» means the arrangement through which a CIF that is a member/ participant or user of a trading platform permits specified clients (including eligible counterparties) to transmit orders electronically to the CIF's internal electronic trading systems for automatic onward transmission under the CIF's trading ID to a specified trading platform.

«*Suspicious Transaction Report (STR)*» means reports to the Commission required under articles 40 and 41(1) of the Insider Dealing and Market Manipulation (Market Abuse) Law, where a person professionally arranging transactions reasonably suspects that a transaction might constitute insider dealing or market manipulation.

«*Sponsored Access (SA)*» means the arrangement through which a CIF that is a member/participant or user of a trading platform permits specified clients (including eligible counterparties) to transmit orders electronically and directly to a specified trading platform under CIF's trading ID without the orders being routed through the CIF's internal electronic trading systems.

«*other relevant Union legislation*» means the legislation issued and applied within the European Union without necessarily requiring the adoption and implementation into national law of each Member State.

«*Market Abuse Law*» means the Insider Dealing and Market Manipulation (Market Abuse) Law.

«*Trading Platform*» means a regulate market (RM) or multilateral trading facility (MTF).

4. These guidelines do not reflect absolute obligations. For this reason, the word "should" is often used. However, the words "must" or "are required" are used when describing a requirement of the Law.

### **III. APPLICATION**

5. These guidelines cover:
  - i. the operation of an electronic trading system by a regulated market or a multilateral trading facility;
  - ii. the use of an electronic trading system, including a trading algorithm, by a CIF for dealing on own account or for the execution of orders on behalf of clients; and
  - iii. the provision of direct market access or sponsored access by a CIF as part of the service of the execution of orders on behalf of clients.
6. These guidelines have implications for firms not authorised as market operators or CIF under the Law. These include firms who sell electronic trading systems to market operators or CIF, or act as the outsourced providers of such systems, or provide connectivity services to CIF when accessing trading platforms. Such firms will be affected by trading platforms' and CIF' obligations in relation to their electronic trading systems.
7. These guidelines will also affect firms exempt in accordance with section 3(2) of the Law who trade on own account and access trading platforms directly as members, participants or users, or through DMA or SA. They will be affected by these guidelines on fair and orderly trading for trading platforms in relation to the requirements for members, participants and users who are not authorised, and the guidelines for trading platforms and CIF relating to DMA and SA.
8. References in these guidelines to 'CIF' relate to CIFs when executing orders on behalf of clients and/or dealing on own account in an automated trading

environment. A CIF when operating a multilateral trading facility is covered by these guidelines relating to trading platforms.

9. The scope of electronic trading systems used by CIF includes electronic systems to send orders to trading platforms (whether or not orders from clients are submitted electronically to the CIF) and electronic systems which automatically generate orders i.e. trading algorithms. Smart order routers may be part of a CIF's systems for sending orders to trading platforms. For the purposes of these guidelines, the Commission examines smart order routers only from the perspective of the risks involved in order entry and not, for example, in relation to best execution.
10. These guidelines are not restricted to the trading of shares but cover trading in an automated environment of any financial instrument, as defined in Part III of the Third Appendix of the Law.
11. For both trading platforms and CIFs, the systems and controls employed in complying with these guidelines should take into account the nature, scale and complexity of their business.
12. These guidelines shall enter into force two (2) months after they are posted on the website of the Commission.

#### **IV. PURPOSE**

13. The purpose of these guidelines is to ensure the common, uniform and consistent application of provisions of the Law and of the Market Abuse Law, as they apply to the systems and controls required of:

- trading platforms and CIFs in an automated trading environment; and
- trading platforms and CIFs in relation to the provision of DMA or SA.

#### **V. GUIDELINES ON SYSTEMS AND CONTROLS IN AN AUTOMATED TRADING ENVIRONMENT FOR TRADING PLATFORMS AND CIFs**

**V.I Organisational requirements for regulated markets’ and multilateral trading facilities’ electronic trading systems** (relevant legislation – for regulated markets: sections 99(b) and 99(c) of the Law, and for MTFs, sections 18(2)(a), 18(2)(c), 18(2)(d), 18(2)(f), 18(2)(g), 19(1)(a), 28(2), 43, 44, 77(6) and 114 of the Law and paragraphs 4, 5, 6, 8, 9, 10, 11, 12 and 16 of the Directive.

***General guideline 1***

- 14.** A regulated market’s or multilateral trading facility’s electronic trading system (or systems) shall ensure that it complies with applicable obligations under the law and other relevant Union legislation taking into account technological advancements and trends in the use of technology by its members/participants or users. In particular, the system (or systems) should be well adapted to the business which takes place through it (or them) and is (or are) robust enough to ensure continuity and regularity in the performance of the automated market (or markets) operated by the market operator or CIF.

***Supporting guidelines***

- 15.** In following the general guideline 1, trading platforms should at least take into account the following:

*a) Governance*

- 16.** The governance process is central to compliance with regulatory obligations. Trading platforms should, within their overall governance and decision-making framework, develop, procure (including outsourcing) and monitor their electronic trading systems through a clear and formalised governance process. The 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. 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.

17. In the governance process compliance staff should be responsible for providing clarity about the market operator or CIF's regulatory obligations and the policies and procedures that seek to ensure the use of the trading systems comply with the market operator or CIF's obligations and that any failures to comply are detected. This requires compliance staff to have an understanding of the way in which the trading systems operate but not knowledge of the technical properties of the trading systems.

b) Capacity and resilience

18. Tα Regulated markets' and MTF' electronic trading systems should have sufficient capacity to accommodate reasonably foreseeable volumes of messaging and that are scalable to allow for capacity to be increased in order to respond to rising message flow and emergency conditions that might threaten their proper operation.

c) Business Continuity

19. Trading platforms should have effective business continuity arrangements in relation to their electronic trading systems to address disruptive incidents, including but not limited to system failures. The business continuity arrangements should ensure a timely resumption of trading, including but not limited to system failures. The arrangements should cover, as appropriate, matters such as:
  - 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.

d) Testing

- 20.** Trading platforms should prior to deploying an electronic trading system, and prior to deploying updates, make use of clearly delineated development and testing methodologies. The use of these methodologies should 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 the Law and other relevant Union legislation, 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.

e) Monitoring and review

- 21.** Trading platforms should monitor in real time their electronic trading systems. 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. Decisions on action to deal with problems with electronic trading systems should take due account of the need, as far as possible, for those operating trading platforms to act in an orderly manner.
- 22.** In order to ensure that trading platforms remain continually effective, the operators of these trading platforms should periodically review and evaluate their electronic trading systems, and associated process for governance, accountability and sign-off and associated business continuity arrangements.



They should act on the basis of these reviews and evaluations to remedy deficiencies. 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.

*f) Security*

- 23.** Trading platforms should have procedures and arrangements for physical and electronic security designed to protect their electronic trading systems from misuse or unauthorised access and to ensure the integrity of the data that is part of or passes through the systems.

*g) Staffing*

- 24.** Trading platforms should have procedures and arrangements, including recruitment and training, to determine their staffing requirements and then to ensure they employ sufficient number of staff with the necessary skills and expertise to manage their electronic trading systems. This will include employing staff with knowledge of relevant electronic trading 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 MTF and of the regulated markets' or MTFs' regulatory obligations.

*h) Record keeping and cooperation*

- 25.** Trading platforms should keep records in relation to their electronic trading systems covering at least the matters referred to in paragraphs 16 to 24 above. That will include information about key decisions, system properties, testing methodologies, test results and periodic reviews. The records should be sufficiently detailed to enable the Commission to monitor compliance with relevant obligations of the trading platform. Market operators and CIFs operating MTFs should keep the records for at least 5 years. Market operators operating regulated markets should keep them for at least as long as required by their home competent authority.

26. Trading platforms should inform the Commission, about any significant risks that may affect the sound management of the technical operations of the system and major incidents where those risks crystallise.

**VII. Organisational requirements for CIFs' electronic trading systems (including trading algorithms)** (relevant legislation: sections 18(2)(a), 18(2)(c), 18(2)(d), 18(2)(f), 18(2)(g), 28(2), 43, 44, 77(6) and 114 of the Law and paragraphs 4, 5, 6, 8, 9, 10, 11, 12 and 16 of the Directive).

***General guideline 2***

27. A CIFs' electronic trading system (or systems), including trading algorithms, shall ensure that the firm complies with applicable obligations under Law and other relevant Union legislation as well as the rules of the trading platforms to which it sends orders. In particular, the system (or systems) should be well adapted to the business which takes place through it (or them) and is (or are) robust enough to ensure continuity and regularity in the performance of its investment services and activities in an automated trading environment.

***Supporting guidelines***

28. In following the general guideline 2, CIFs should at least take into account the following:

a) *Governance*

29. The governance process is central to compliance with regulatory obligations. CIFs 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. 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. 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.

- 30.** In the governance process compliance staff should be responsible for providing clarity about the CIF's regulatory obligations and the policies and procedures that seek to ensure the use of the trading systems and algorithms comply with the CIF's obligations and that any failures to comply are detected. This means compliance staff need to understand the way in which trading systems and algorithms operate, but not knowledge of the technical properties of the trading systems or algorithms.

*b) Capacity and resilience*

- 31.** CIF'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.

*c) Business Continuity*

- 32.** CIFs 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:

- i. Governance for the development and deployment of the arrangements;

- ii. Consideration of an adequate range of possible scenarios related to the operation of their electronic trading systems which require specific continuity arrangements;
- iii. The backing up of business (including compliance) critical data that flows through their electronic trading systems;
- iv. The procedures for moving to and operating the electronic trading system from a back-up site;
- v. Staff training on the operation of the arrangements and individuals' roles within them; and
- vi. 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.

d) Testing

- 33. CIFs 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). 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 CIF's obligations under the Law and other relevant Union legislation 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.
- 34. CIFs 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 CIF 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. CIFs should undertake further testing if the markets in which the algorithm is to be used changes from those originally intended.

35. CIFs 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.

e) Monitoring and Review

36. CIFs 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 immediately shut down their electronic trading system or trading algorithm. CIFs, when taking action to deal with problems with their electronic trading systems should, as far as possible, take due account of the need, as far as possible, for members/participants and users of regulated markets to act in an orderly manner.
37. CIFs 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. 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.

*f) Security*

- 38.** CIFs should 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.

*g) Staffing*

- 39.** CIFs 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 CIF deploys through its trading systems and algorithms and of CIFs' regulatory obligations.

*h) Record keeping and co-operation*

- 40.** CIFs should keep, for at least five years, records of their electronic trading systems (and trading algorithms) in relation to the matters covered in paragraphs 29 to 39 above, 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 the Commission to monitor CIFs' compliance with their relevant obligations.
- 41.** CIFs should inform the Commission, 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.

**VIII. Organisational requirements for regulated markets and MTFs to promote fair and orderly trading in an automated trading environment** (relevant

legislation – for regulated markets: sections 99(b), 99(c), 99(d), 106, 107 and 108 of the Law, and for MTFs: sections 18(2)(a), 18(2)(d), 18(2)(f), 18(2)(g), 19(1)(a), 19(1)(d), 43, 44, 46, 77(6), 106(3) and 114 of the Law and paragraphs 3 and 16 of the Directive.

### ***General guideline 3***

- 42.** Regulated markets' and MTFs' rules and procedures for fair and orderly trading on their electronic markets should be appropriate to the nature and scale of trading on those markets, including the types of members, participants and users and their trading strategies.

### ***Supporting guidelines***

- 43.** In following the general guideline 3, the rules and procedures of trading platforms should at least include:

*α) Requirements for members or participants who are not credit institutions or investment firms under EU law*

- 44.** Trading platforms should perform adequate due diligence on applications to become a member/participant or user from persons who are not credit institutions or investment firms under EU law.

- 45.** Trading platforms should have organisational requirements for members or participants who are not credit institutions or investment firms (taking account as necessary of the controls imposed on firms authorised outside the EEA), including requirements on the monitoring of trading against the rules of the platform and the management of risk. Trading platforms' rules should require members/participants and users who are not CIFs to follow the guidelines laid down in these guidelines for CIFs.

*β) IT compatibility*

- 46.** Trading platforms should have standardised conformance testing to ensure that the systems that members and participants are using to access the platform have a minimum level of functionality that is compatible with the trading platforms' electronic trading system and will not pose a threat to fair and orderly trading on the platform.

*c) Pre and post-trade controls*

- 47.** To ensure that there is orderly trading on the platform, trading platforms should have minimum requirements for members'/participants' and users' pre- and post-trade controls on their trading activities (including controls to ensure that there is no unauthorised access to trading systems). In particular, there should be controls on filtering order price and quantity (this requirement is without prejudice to the responsibility of members/participants or users to implement their own pre and post-trade controls).

*d) Trader access and knowledge*

- 48.** Trading platforms should have standards covering the knowledge of persons within members/ participants and users who will be using order entry systems.

*e) Limits to access and intervention on transactions*

- 49.** Trading platforms should have the ability to prevent in whole or in part the access of a member or participant to their markets and to cancel, amend or correct a transaction. The rules and procedures for cancelling, amending or correcting trades should be transparent to members/participants and users of the regulated market or MTF.

*f) Measures to cope with excessive flooding of the order book*

- 50.** Trading platforms should have 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.



g) Prevention of capacity limits from being breached

51. Trading platforms should have arrangements (such as throttling) to prevent capacity limits on messaging from being breached. At a minimum, the framework of those arrangements should be made available to members/participants and users.

h) Measures to constrain or halt trading

52. Trading platforms should have arrangements (for example, volatility interruptions or automatic rejection of orders which are outside of certain set volume and price thresholds) to constrain trading or to halt trading in individual or multiple financial instruments when necessary, to maintain an orderly market. At a minimum the framework of those arrangements should be made available to members/participants and users.

j) Obtaining information from members/participants and users

53. Trading platforms should have the ability to obtain information from a member/participant or user to facilitate monitoring of compliance with the rules and procedures of the regulated market or MTF relating to organisational requirements and trading controls.

k) Monitoring

54. Trading platforms should, whenever the trading platform is in operation, monitor their markets as close to real time as possible for possible signs of disorderly trading. This monitoring should be conducted by staff who understands the functioning of the market. Those staff should be accessible to the Commission and should have the authority to take remedial action, when necessary, to protect fair and orderly trading.

l) Record keeping and co-operation

55. Trading platforms should keep records of the matters covered by paragraphs 44 to 54 above, including of issues which emerge in relation to the policies and procedures mentioned. The records should be sufficiently detailed to enable the Commission to monitor compliance with relevant obligations of trading platforms. Market operators and CIFs operating MTFs should keep the records for at least 5 years. Market operators operating regulated markets should keep them for at least as long as required by their home competent authority.
56. Trading platforms should inform the Commission about significant risks that may affect fair and orderly trading and major incidents where those risks crystallise.

**VIV. Organisational requirements for CIFs to promote fair and orderly trading in an automated trading environment** (relevant legislation: sections 18(2)(a), 18(2)(c), 18(2)(d), 18(2)(f), 18(2)(g), 28(2), 43, 44, 77(6) and 114 of the Law and paragraphs 4, 5, 6, 9, 10, 11, 12 and 16 of the Directive)

***General guideline 4***

57. CIFs must have policies and procedures to ensure that their automated trading activities, including where they are providing DMA or SA, on trading platforms comply with their regulatory requirements under the Law and other relevant Union legislation and, in particular, and that they manage the risks relating to those trading activities.

***Supporting guidelines***

58. In following the general guideline 4, CIFs' automated trading activities should at least take account of the following points:

a) *Price or size parameters*

- 59.** CIFs 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*

- 60.** CIFs 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*

- 61.** CIFs should be able to automatically block or cancel orders where they risk compromising the CIF'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 CIF as a whole.

*d) Consistency with the regulatory and legal framework*

- 62.** The electronic systems of CIFs, and the orders these generate, should be consistent with the CIF's obligations under Law, or other relevant Union legislation, or under the rules of the regulated market or MTF to which the order is to be sent (including rules relating to fair and orderly trading).

*e) Reporting obligations to supervisory arrangements*

- 63.** CIFs should inform the Commission about significant risks that may affect fair and orderly trading and major incidents where those risks crystallise.

*f) Overriding of pre-trade controls*

- 64.** CIFs should have procedures and arrangements for dealing with orders which have been automatically blocked by the CIF's pre-trade controls but which the CIF 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*

- 65.** CIFs 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*

- 66.** CIFs 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 CIF's trading flow. These staff members should be accessible to the Commission and to the trading platforms on which the CIF is active and should have the authority to take remedial action, when necessary.

*i) Close scrutiny by compliance staff*

- 67.** CIFs should ensure that compliance staff are able to follow closely the CIF's electronic trading activity so that they can quickly respond to and correct any failures or regulatory infractions that may take place.

*j) Control of messaging traffic*

- 68.** CIFs should ensure that they have control of messaging traffic to individual trading platforms.

k) Management of operational risk

69. CIFs 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 the Committee of European Banking Supervisors' (CEBS) Guidelines on the Management of Operational Risk in Market-Related Activities<sup>1</sup>.

l) IT Compatibility

70. CIFs should ensure that the systems 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

71. CIFs should keep records, for at least five years, of the matters covered by paragraphs 59-70 above. The records should be sufficiently detailed to enable the Commission to monitor CIFs' compliance with their relevant obligations.
72. CIFs should inform the Commission about significant risks that may affect fair and orderly trading and major incidents where those risks crystallise.

**V.V Organisational requirements for regulated markets and MTFs to prevent market abuse (in particular market manipulation) in an automated trading environment** (relevant legislation – for regulated markets: sections 99(b), 99(d) and 108 of the Law and sections 24, 40, 41(1), 41(3), 42 and 43 of the Market Abuse Law, and for MTFs: sections 18(2)(a), 18(2)(d), 18(2)(f), 18(2)(g), 19(1)(a), 28(2), 43, 44, 46, 77(6) and 114 of the Law, paragraphs 4, 5, 6, 8, 9,

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<sup>1</sup>Available at [http://www.eba.europa.eu/documents/Publications/Standards/Guidelines/2010/Management-of-op-risk/CEBS-2010-216-\(Guidelines-on-the-management-of-op-.aspx\)](http://www.eba.europa.eu/documents/Publications/Standards/Guidelines/2010/Management-of-op-risk/CEBS-2010-216-(Guidelines-on-the-management-of-op-.aspx)

10, 11 and 12 of the Directive and section 24, 40, 41(1), 41(3), 42 and 43 of the Market Abuse Law)

### ***General guideline 5***

- 73.** Trading platforms 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 an automated trading environment.
- 74.** Potential cases of market manipulation that could be of particular concern in an automated trading environment include:
- i. **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.
  - ii. **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.
  - iii. **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.
  - iv. **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.

### ***Supporting guidelines***

75. In following the general guideline 5, the arrangements and procedures of trading platforms which seek to prevent and identify conduct by their members/participants and users that may involve market abuse and in particular market manipulation in an automated trading environment should at least include:

a) Staffing

76. Trading platforms should have sufficient staff with an understanding of regulation and trading activity and the skill to monitor trading activity in an automated trading environment and identify behaviour giving rise to suspicions of market abuse (in particular market manipulation) in case monitoring market abuse falls under their responsibility.

b) Monitoring

77. Trading platforms should at least have 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, including, where the trading platform has sight of this, cross-market behaviour) 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.

c) Arrangements for the identification and reporting of suspicious transactions and orders

78. Trading platforms should have in place arrangements to identify transactions, and it is also recommended that these arrangements also cover orders<sup>2</sup>, that require an STR to the Commission 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).

d) Reviews

79. Trading platforms should conduct periodic reviews and internal audits of procedures and arrangements to prevent and identify instances of conduct that may involve market abuse.

e) Record keeping

80. Trading platforms should keep records of the matters covered by paragraphs 76 to 79 above, including effective audit trails regarding how each alert of possible suspicious behaviour is dealt with whether or not a report is made to the Commission. The records should be sufficiently detailed to enable the Commission to monitor compliance with their relevant obligations of trading platforms. Market operators and CIFs operating MTFs should keep the records for at least 5 years. Market operators operating regulated markets should keep them for at least as long as required by their home competent authority.

**V.VI Organisational requirements for investment firms to prevent market abuse (in particular market manipulation) in an automated trading environment**  
(relevant legislation: sections 18(2)(a), 18(2)(d), 18(2)(f), 18(2)(g), 28(2), 43, 44, 77(6) and 114 of the Law, paragraphs 4, 5, 9, 10, 11, 12 of the Directive and sections 24, 40, 41(1), 41(3), 42 and 43 of the Market Abuse Law

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<sup>2</sup> CESR's first and third set of Level 3 guidance on the implementation of the MAD, CESR has already provided guidelines on suspicious transactions reports (STR), which state: "CESR is of the view that where an unexecuted order for a transaction gives rise to a suspicion of market abuse, this suspicion is recommended, when not already legally required on a national basis, to be reported to the competent authority." The guidance also provides a standard STR report form (Sections IV and V of the May 2005 guidance (Ref: CESR/04-505b) and Section 2 of the May 2009 guidance (Ref: CESR/09-219)).



### ***General Guideline 6***

- 81.** CIFs should have policies and procedures in place to minimise the risk that their automated trading activity gives rise to market abuse (in particular market manipulation).
- 82.** The sorts of market manipulation that might be of particular concern in a highly automated trading environment were described in guideline 5 (paragraph 72).

### ***Supporting guidelines***

- 83.** In following the general guideline the policies and procedures of CIFs engaging in automated trading activities should at least include:

- a) Understanding, skill and authority of compliance staff*

- 84.** CIFs 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*

- 85.** CIFs 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*

- 86.** CIFs should monitor the activities of individuals/algorithms trading on behalf of the CIF 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 CIF has sight of this) cross-market behaviour.

*d) Arrangements for the identification and reporting of suspicious transactions and orders*

- 87.** CIFs should have arrangements to identify transactions, and it is recommended that these arrangements also cover orders, that require a STR to the Commission 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*

- 88.** CIFs 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*

- 89.** CIFs 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 paragraphs 84 to 88 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 Commission. These records should be sufficiently detailed to enable the Commission to monitor the CIFs' compliance with their relevant obligations.

***V.VII Organizational requirements for regulated markets and MTFs whose members/participants and users provide direct market access/sponsored***

**access** (relevant legislation: for regulated markets: sections 99(b) and 108(1) of the Law, and for MTFs: sections 18(2)(a), 18(2)(d), 18(2)(f), 18(2)(g), 19(1)(a), 28(2), 43, 44, 46(1), 77(6) and 114 of the Law and paragraphs 4, 5, 6, 8, 9, 10, 11 and 12 of the Directive)

### ***General guideline 7***

- 90.** Trading platforms should have rules and procedures which seek to ensure that, where they allow members/participants or users to provide direct market access/sponsored access (DMA/SA), the provision of DMA/SA is compatible with fair and orderly trading. It is important that trading platforms and their members/participants retain control of and closely monitor their systems to minimise any potential disruption caused by these third parties to avoid that trading platforms are vulnerable to either the potential misconduct or market abuse of DMA/SA clients or to their inadequate/erroneous systems.

### ***Supporting guidelines***

- 91.** In following the general guideline, trading platforms should set out whether or not it is permissible for their members/participants or users to offer DMA and/or SA. Where they allow members or participants to offer DMA and/or SA, their rules and procedures should at least take account of the following:
- a) Ultimate responsibility for messages, including orders, and eventual interventions and sanctions*
- 92.** Trading platforms should make clear that the member/participant or user is solely responsible for all messages, including orders entered under its trading codes and therefore may be subject to interventions (including cutting the access of the member/participant or user to the trading platform) and sanctions for any breaches of the rules or procedures in respect of those orders.
- b) Subsidiary responsibility when providing DMA/SA*

- 93.** DMA/SA arrangements between trading platforms and a DMA/SA provider firm should stress that the direct market access/sponsored access provider firm remains responsible to the trading platform for all trades using their market participant ID code or any other identification.

*c) Requirements for members/participants to provide DMA/SA*

- 94.** As per guideline 3, trading platforms should require members/participants or users to have adequate systems and effective controls, including pre- and post-trade controls, to ensure that the provision of DMA/SA 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. This applies equally where a member/participant or user provides DMA/SA.

*d) Due diligence prior to the provision of DMA/SA*

- 95.** Trading platforms should require members/participants or users to conduct due diligence on clients to which they provide DMA/SA.

*e) Rights of access*

- 96.** Trading platforms should be able to refuse a request from a member/participant or user to allow a client to be provided with SA where the regulated market or MTF is not satisfied that this would be consistent with its rules and procedures for fair and orderly trading. In relation to naked SA please refer to guideline 8.

*f) Monitoring of orders*

- 97.** Trading platforms should, as part of their obligations to monitor their markets under guideline 3, monitor orders sent to their systems by a member/participants' SA clients.

*g) Potential interventions over SA*

98. Trading platforms should be able to suspend or withdraw the SA after it has been granted where the regulated market or MTF is not satisfied that continued access would be consistent with its rules and procedures for fair and orderly trading.
99. Trading platforms should have the ability to stop orders from a person trading through SA separately from the orders of the member or participant sponsoring that person's access by assigning unique customer IDs to clients that are accessing the market via SA.
100. Trading platforms should be able to carry out, where necessary, a review of a member/participant or users' internal risk control systems in relation to their sponsored access or direct market access clients.

η) Record keeping

101. Trading platforms should keep records of their policies and procedures relating to DMA/SA and any significant incidents relating to SA trading. The records should be sufficiently detailed to enable the Commission to monitor compliance with relevant obligations of trading platforms. Market operators and CIFs operating MTF should keep the records for at least 5 years. Market operators operating regulated markets should keep them for at least as long as required by their home competent authority.

**V.VIII Organisational requirements for CIF that provide direct market access and/or sponsored access** (relevant legislation: sections 18(2)(a), 18(2)(d), 18(2)(f), 18(2)(g), 28(2), 43, 44, 77(6) and 114 of the Law and paragraphs 4, 5, 6, 8, 9, 10, 11, 12, 16 of the Directive)

***General guideline 8***

102. CIFs offering DMA/SA to clients ('DMA/SA clients') are responsible for the trading of those clients. They must establish policies and procedures to ensure

the trading of those clients complies with the rules and procedures of the relevant trading platforms to which the orders of such clients are submitted and enables the CIF to meet its obligations under the Law and other relevant Union legislation.

### ***Supporting guidelines***

**103.** In following the general guideline 8, CIFs should at least take account of the following:

*a) Due diligence on direct market access/sponsored access clients*

**104.** CIFs 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 CIF. In the process of due diligence CIFs 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*

**105.** Pre-trade controls should be carried out on the orders of DMA/SA clients of the sort covered in paragraphs 57-70 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.

**106.** There should be absolute clarity that the CIF 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).

**107.** CIFs offering DMA/SA can use pre- and post-trade controls which are proprietary controls of the CIF, 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 CIF remains responsible for the effectiveness of the controls and has to be solely responsible for setting the key parameters.

c) 'Naked' or 'unfiltered' market access

**108.** '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 the Law. 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 CIF.

d) Monitoring

**109.** The monitoring of orders (including on a cross-market basis) that CIFs 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.

**110.** To comply with these obligations CIFs will need to be able to separately identify orders and transactions of DMA/SA clients from other orders and transactions of the CIF.

**111.** CIFs should also have the ability to immediately halt trading by individual direct market access/sponsored access clients.

*e) Rights and obligations of the parties*

**112.** CIFs should establish clarity about the rights and obligations of both parties in relation to the DMA/SA service.

*f) Record keeping*

**113.** CIFs should keep, for at least five years, records of the matters covered in paragraphs 104-112 above that are sufficiently detailed the Commission to monitor the CIF's 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.



**APPENDIX**  
**RELEVANT LEGISLATION**

**A. Law L144 (I)/2007**

**1. Section 18(2): A CIF must:**

- (a) Establish adequate policies and procedures sufficient to ensure its compliance, including its managers, employees, tied agents and other relevant persons, with its obligations pursuant to this Law and the directives issued pursuant to this Law, as well as appropriate rules governing personal transactions by such persons;
- (b) ...
- (c) take reasonable steps to ensure continuity and regularity in the performance of investment and ancillary services and activities, by employing appropriate and proportionate systems, resources and procedures;
- (d) ensure, when relying on a third party for the performance of investment services or activities or operational functions which are critical for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis, that it takes reasonable steps to avoid undue additional operational risk. Outsourcing of the above must not be undertaken in such a way as to materially impair the quality of its internal control and the ability of the Commission to monitor the CIF's compliance with all its obligations;
- (e) ...
- (f) have sound administrative and accounting procedures, internal control mechanisms, effective procedures for assessing the risks the CIF undertakes or may undertake, and effective control mechanisms; including appropriate administrative and accounting procedures and safeguard arrangements for information processing systems;
- (g) *va* arrange for records to be kept of all services provided and transactions undertaken by it, which shall be sufficient to enable the Commission to monitor compliance with the requirements under this Law, the directives issued pursuant to this Law and the Regulation (EC) No 1287/2006, and in

particular to ascertain that the CIF has complied with all its obligations with respect to clients or potential clients;...

2. Section 19(1)(a): Establish transparent and non-discretionary rules and procedures for fair and orderly trading and establish objective criteria for the efficient execution of orders;
3. Section 28(2): A CIF must carry out regular internal review of the conditions stated in sections 18 and 19 to ensure that they remain appropriate, effective, comprehensive and proportionate to the nature, scale and complexity of the CIF's business activities especially in terms of the nature and the range of the investment services and activities it undertakes in terms of the said business activities. In the opposite case, the CIF must take appropriate measures to correct possible deficiencies.
4. Section 43: (1) A CIF must maintain records that contain-
  - (a) The relevant details relating to all transactions in financial instruments carried out by the CIF, whether on own account or on behalf of clients;
  - (b) the respective rights and obligations of the CIF and its clients as set out in an agreement to provide services or the terms on which the CIF provides services to the clients.(2) The Commission may, by way of directives define the form, type and content of the records provided for in subsection (1), as well as any other relevant to the said records matter or necessary detail.
5. Section 44: (1) A CIF must maintain the records provided for in subsection (1) of section 43 for a period of at least five years, and these shall be available for review by the Commission, at any given time.  
  
(2) Without prejudice to subsection (1), the records provided for in paragraph (b) of subsection (1) of section 43 shall be retained for at least the duration of the CIF's relationship with the client.

(3) The Commission may, in exceptional circumstances, require a CIF to retain any or all of those records provided for in subsection (1) of section 43 for a longer period than that provided in this section, as shall be justified by the nature of the instrument or transaction, if that is necessary to enable the Commission to exercise its supervisory functions pursuant to this Law.

(4) After the lapse or the withdrawal of a CIF authorisation, the Commission may request from the company whose CIF authorisation has lapsed or withdrawn, to maintain the records provided for in subsection (1) of section 43 for the remainder of the five year period stated in subsection (1).

6. Section 77(6): The IF must ensure that all services provided and transactions undertaken by its branch in the Republic are recorded in a way which enables the Commission to monitor its compliance with all its obligations in respect of its clients or potential clients. This obligation is enforced without prejudice to the possibility of the competent authority of the home member state to have direct access to the relevant records.

7. Section 99: Η ρυθμιζόμενη αγορά πρέπει να διαθέτει:

(a) ...

(b) be adequately equipped to manage the risks to which it is exposed, to implement appropriate arrangements and systems to identify all significant risks to its operation, and to put in place effective measures to mitigate those risks;

(c) have arrangements for the sound management of the technical operations of the system, including the establishment of effective contingency arrangements to cope with risks of systems disruptions;

(d) have transparent and non-discretionary rules and procedures that provide for fair and orderly trading and establish objective criteria for the efficient execution of orders;... .

8. Section 106: (1) A regulated market must establish and maintain transparent and non-discriminatory rules, based on objective criteria, governing access to or membership of the regulated market.

(2) The rules stated in subsection (1) shall specify all the obligations for the members or participants of the regulated market arising from –

- (a) The constitution and administration of the regulated market;
- (b) rules relating to transactions on the market;
- (c) professional standards imposed on the staff of CIFs, remaining IFs or credit institutions that are operating on the market;
- (d) the conditions established, for members or participants other than CIFs, remaining IFs or credit institutions, under subsection (3);
- (e) the rules and procedures for the clearing and settlement of transactions concluded on the regulated market.

(3) A regulated market may admit as members or participants CIFs, remaining IFs, credit institutions and other persons who –

- (a) Are fit and proper;
- (b) have a sufficient level of trading ability and competence;
- (c) have, where applicable, adequate organisational arrangements;
- (d) have sufficient resources for the role they are to perform, taking into account the different financial arrangements that the regulated market may have established in order to guarantee the adequate settlement of transactions.

(4) With regards transactions concluded on a regulated market, its members or participants are not obliged to apply to each other the obligations laid down in sections 36, 38 and 39, however, they must apply them with respect to their clients when they, acting on behalf of their clients, execute their orders on a regulated market.

(5) The rules on access to or membership of the regulated market provide for the direct or remote participation of CIFs, remaining IFs and credit institutions.

(6) A regulated market authorised in the Republic may provide appropriate arrangements in other member states so as to facilitate access to and trading by remote members or participants established in the other member state. The regulated market shall communicate to the Commission its intention to provide such arrangements.

The Commission shall communicate, within one month, this information to the member state in which the regulated market intends to provide such arrangements.

The Commission shall, on the request of the competent authority of the host member state and within a reasonable time, communicate the identity of the members or participants of the regulated market established in that host member state.

(7) The operator of the regulated market must communicate, on a regular basis, the list of the members or participants of the regulated market to the Commission.

**9. Section 107:** (1) A regulated market authorised in another member state may provide appropriate arrangements in the Republic so as to facilitate access to and trading by remote members or participants established in the Republic, only after relevant notification is sent to the Commission by the competent authority of its home member state.

(2) The Commission may request from the competent authority of the home member state of the regulated market to be informed on a regular basis of the identity of the members or participants of the regulated market established in the Republic.

**10. Section 108:** (1) A regulated market must establish and maintain effective arrangements and procedures for the regular monitoring of the compliance by its members or participants with its rules. A regulated market shall monitor the transactions undertaken by its members or participants under its systems in order

to identify breaches of those rules, disorderly trading conditions or conduct that may involve market abuse.

(2) The operator of the regulated market-

- (a) Must report to the Commission significant breaches of its rules or disorderly trading conditions or conduct that may involve market abuse;
- (b) must supply the relevant information without delay to the Commission and provide full assistance to the latter in investigating and prosecuting market abuse occurring on or through the systems of the regulated market.

**11. Section 114:** Every CIF must submit to the Commission within four months from the end of the financial year, financial accounts that provide a true and fair picture of the CIF and are in accordance with the applicable accounting standards and rules. The said financial accounts must be audited by an auditor and accompanied by a signed copy of its report.

**B. Directive DI 144-2007-01**

**12. Paragraphs 4:** (1) A CIF is required to comply with the following organisational requirements:

- (a) to establish, implement and maintain decision-making procedures and an organisational structure which clearly and in documented manner specifies reporting lines and allocates functions and responsibilities;
- (b) to ensure that its relevant persons are aware of the procedures which must be followed for the proper discharge of their responsibilities;
- (c) to establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the CIF;
- (d) to employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them;

- (e) to establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the CIF;
- (f) to maintain adequate and orderly records of its business and internal organisation;
- (g) to ensure that the performance of multiple functions by its relevant persons does not and is not likely to prevent those persons from discharging any particular function soundly, honestly, and professionally.

(2) At the compliance with the abovementioned requirements, a CIF takes into account the nature, scale and complexity of the business of the firm, and the nature and range of investment services and activities undertaken in the course of that business.

- 13. Paragraph 5:** (1) A CIF is required to establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the firm to comply with its obligations under the Law, as well as the associated risks, and put in place adequate measures and procedures designed to minimise such risk and to enable the Commission to exercise its powers effectively under the Law and the current Directive.

For these purposes, a CIF takes into account the nature, scale and complexity of the business of the firm, and the nature and range of investment services and activities undertaken in the course of that business.

(2) A CIF is required to establish and maintain a permanent and effective compliance function which operates independently and which has the following responsibilities:

- (a) to monitor and to assess the adequacy and effectiveness of the measures and procedures put in place in accordance with the subparagraph (1), and the

actions taken to address any deficiencies in the CIF's compliance with its obligations under the Law and the Directive;

- (b) to advise and assist the relevant persons responsible for carrying out investment services and activities to comply with the CIF's obligations under the Law and the Directive.

(3) In order to enable the compliance function to discharge its responsibilities properly and independently, a CIF is required to ensure that the following conditions are satisfied:

- (a) the compliance function must have the necessary authority, resources, expertise and access to all relevant information;
- (b) a compliance officer must be appointed and must be responsible for the compliance function and for any reporting as to compliance required by paragraph 9(2);
- (c) the relevant persons involved in the compliance function must not be involved in the performance of services or activities they monitor;
- (d) the method of determining the remuneration of the relevant persons involved in the compliance function must not compromise their objectivity and must not be likely to do so.

However, a CIF is not required to comply with point (c) or point (d) if it is able to demonstrate that in view of the nature, scale and complexity of its business, and the nature and range of investment services and activities, the requirement under that point is not proportionate and that its compliance function continues to be effective.

**14. Paragraph 6:** (1) A CIF is required:

- (a) to establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the CIF's activities, processes and systems, and where appropriate, set the level of risk tolerated by the CIF;



(b) to adopt effective arrangements, processes and mechanisms to manage the risks relating to the CIF's activities, processes and systems, in light of that level of risk tolerance;

(c) to monitor the following:

(i) the adequacy and effectiveness of the CIF's risk management policies and procedures;

(ii) the level of compliance by the CIF and its relevant persons with the arrangements, processes and mechanisms adopted in accordance with point (b);

(iii) the adequacy and effectiveness of measures taken to address any deficiencies in those policies, procedures, arrangements, processes and mechanisms, including failures by the relevant persons of the CIF to comply with such arrangements, processes and mechanisms or follow such policies and procedures.

(2) A CIF is required, where appropriate and proportionate in view of the nature, scale and complexity of their business and the nature and range of the investment services and activities undertaken in the course of that business, to establish and maintain a risk management function that operates independently and carries out the following tasks:

(a) to implement the policy and procedures referred to in subparagraph (1);

(b) to provide the reports and advice to senior management according to paragraph 9(2).

Where a CIF is not required, under the abovementioned subparagraph (2), to establish and maintain a risk management function that functions independently, it must nevertheless be able to demonstrate that the policies and procedures that it

has adopted, in accordance with subparagraph (1), satisfy the requirements of the abovementioned subparagraph (2) and are consistently effective.

**15. Paragraph 8:** A CIF is required, where appropriate and proportionate, taking into account the nature, the scale and the complexity of its business activities, as well as the nature and the range of its investment services and activities, to establish and maintain an internal audit function which is separate and independent from the other functions and activities of the CIF and which has the following responsibilities:

- (a) to establish, implement and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the CIF's systems, internal control mechanisms and arrangements;
- (b) to issue recommendations based on the result of work carried out in accordance with point (a);
- (c) to verify compliance with the recommendations of point (b);
- (d) to report in relation to internal audit matters in accordance with paragraph 9(2).

**16. Paragraph 9:** (1) A CIF is required to, when allocating functions internally, to ensure that senior management, and its Board of Directors, are responsible for ensuring that the CIF complies with its obligations under the Law.

In particular, senior management and its Board of Directors are required to assess and periodically review the effectiveness of the policies, arrangements and procedures put in place to comply with the obligations under the Law and the Directive and to take appropriate measures to address any deficiencies.

(2) A CIF is required to ensure that its senior management receive on a frequent basis, and at least annually, written reports on the matters covered by paragraphs 5, 6 and 8 indicating in particular whether the appropriate remedial measures have been taken in the event of any deficiencies.

(3) A CIF is required to ensure that its Board of Directors receives on a regular basis and at least on an annual basis, written reports on the same matters mentioned in subparagraph (2).

(4) A CIF is required to submit to the Commission the minutes of the meetings of the Board of Directors, during which the reports of subparagraph (2) have been discussed. These minutes are submitted to the Commission within twenty days from the date of the relevant meeting and no later than four months after the end of the calendar year, attached to the written reports of subparagraph (2).

17. Paragraph 10: A CIF is required to establish, implement and maintain systems and procedures that are adequate to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question.
18. Paragraph 11: A CIF is required to establish, implement and maintain an adequate business continuity policy aimed at ensuring, in the case of an interruption to its systems and procedures, the preservation of essential data and functions, and the maintenance of investment services and activities, or, where that is not possible, the timely recovery of such data and functions and the timely resumption of its investment services and activities.
19. Paragraph 12: Without prejudice to section 114 of the Law, which refers to the obligation of the CIF to submit audited financial statements, a CIF is required to establish, implement and maintain accounting policies and procedures that enables it, at the request of the Commission, to deliver in a timely manner to the Commission financial reports which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules.
20. Paragraph 16: (1) A CIF that outsources critical or important operational functions or any investment services or activities, remains fully responsible for discharging all of its obligations under the Law and comply, in particular, with the following conditions:

- (a) the outsourcing must not result in the delegation by senior management of its responsibility;
- (b) the relationship and obligations of the CIF towards its clients under the Law must not be altered;
- (c) the conditions with which the CIF must comply in order to be authorised in accordance with section 6 of the Law, and to remain so, must not be undermined;
- (d) none of the other conditions subject to which the CIF's authorisation was granted must be removed or modified.

(2) In the case that outsourcing would conclude to the transfer of functions of the CIF to such a degree which renders the CIF a letter box entity, this is considered to undermine the conditions for authorisation of a CIF, according to Part III of the Law.

(3) A CIF is required to exercise due skill, care and diligence when entering into, managing or terminating any arrangement for the outsourcing to a service provider of critical or important operational functions or of any investment services or activities.

In particular, a CIF should take the necessary steps to ensure that the following conditions are satisfied:

- (a) the service provider must have the ability, capacity, and any authorisation required by law to perform the outsourced functions, services or activities reliably and professionally;
- (b) the service provider must carry out the outsourced services effectively, and to this end the CIF must establish methods for assessing the standard of performance of the service provider;

- (c) the service provider must properly supervise the carrying out of the outsourced functions, and adequately manage the risks associated with the outsourcing;
- (d) appropriate action must be taken if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements;
- (e) the CIF must retain the necessary expertise to supervise the outsourced functions effectively and manage the risks associated with the outsourcing and must supervise those functions and manage those risks;
- (f) the service provider must disclose to the CIF any development that may have a material impact on its ability to carry out the outsourced functions effectively and in compliance with applicable laws and regulatory requirements;
- (g) the CIF must be able to terminate the arrangement for outsourcing where necessary without detriment to the continuity and quality of its provision of services to clients;
- (h) the service provider must cooperate with the Commission in connection with the outsourced activities;
- (i) the CIF, its auditors and the relevant competent authorities must have effective access to data related to the outsourced activities, as well as to the business premises of the service provider;
- (j) the service provider must protect any confidential information relating to the CIF and its clients;
- (k) the CIF and the service provider must establish, implement and maintain a contingency plan for disaster recovery and periodic testing of backup

facilities, where that is necessary having regard to the function, service or activity that has been outsourced.

(4) The respective rights and obligations of the CIF and of the service provider to be clearly allocated and set out in a written agreement.

(5) Where the CIF and the service provider are members of the same group, the CIF may, for the purposes of complying with this paragraph and paragraph 17, take into account the extent to which the CIF controls the service provider or has the ability to influence its actions.

(6) A CIF is required to make available on request to the Commission all information necessary to enable the Commission to supervise the compliance of the performance of the outsourced activities with the requirements of this Directive.

## **C. Market Abuse Law**

**21. Section 24:** (1) Market operators shall adopt structural provisions aimed at preventing and detecting market manipulation practices.

(2) The measures specified in subsection (1) include requirements concerning transparency of transactions concluded, total disclosure of price-regularisation agreements, a fair system of order pairing, introduction of an effective atypical-order detection scheme, sufficiently robust financial instrument reference price-fixing schemes and clarity of rules on the suspension of transactions.

(3) The Commission may by way of a Directive, particularize and/or clarify the matters referred to in the present section.

**22. Section 40:** Any person professionally arranging transactions in financial instruments who reasonably suspects that a transaction or orders to trade might constitute insider dealing or market manipulation shall notify the Commission without delay.

**23. Section 41:** (1) Persons professionally arranging transactions shall decide on a case-by-case basis whether there are reasonable grounds for suspecting that a transaction or order to trade involves insider dealing or market manipulation, taking into account the elements constituting insider dealing or market manipulation, referred to in this Law, as regards the definition and public disclosure of inside information and the definition of market manipulation, referred to in this Law.

(2) ...

(3) The persons referred to in subsection (1), after having become aware of a fact or information that gives reasonable ground for suspicion concerning the relevant transaction or order to trade, shall make a notification without delay.

**24. Section 42:** (1) Persons subject to the notification obligation pursuant to sections 40 and 41 transmit to the Commission the following information:

- (a) A description of the transactions, or the orders for trading, including the type of order, such as limit order, market order or other characteristics of the order and the type of trading market, such as block trade;
- (b) the reasons for suspicion that the transactions, or the orders for trading, might constitute market abuse;
- (c) the means for identification of the persons on behalf of whom the transactions have been carried out, or the orders have been given, and of other persons involved in the relevant transactions or orders;
- (d) the capacity in which the person subject to the notification obligation operates, such as for own account or on behalf of third parties;
- (e) any other information which may have significance in reviewing the suspicious transactions or the orders to trade.

(2) Where that information is not available at the time of notification, the notification shall include at least the reasons why the notifying persons suspect

that the transactions or the orders for trading might constitute insider dealing or market manipulation.

It is provided that all other information is provided to the Commission as soon as it becomes available.

- 25. Section 43:** Any notification to the Commission can be done by mail, electronic mail, facsimile or telephone, provided that in the latter case a written confirmation is provided upon request to the Commission.