

Finalised guidance

Market Operators' oversight of member firm compliance with rules

August 2013

Feedback Statement

- We consulted on our [recommendations](#) for firms and recognised investment exchanges to comply with our requirements for market operators. Here, we set out the responses to that and give our feedback and final guidance.
- In 2009/10, when discussing market operators' Direct Market Access/sponsored access proposals, we became aware that some market operators didn't have adequate oversight of the types of controls members had in place to guard against market abuse and compliance with their rules. Most market operators assessed the arrangements at the point of on-boarding new members, and any other assessment was driven off the back of material failings, generally picked up through their monitoring and surveillance arrangements.
- Other (cash and derivatives) market operators had more systematic arrangements in place to review members' ongoing compliance with their obligations. These reviews have regularly identified material failings (e.g. members offering naked access, i.e. without controls, to clients), which resulted in remedial action by members, and in some cases disciplinary action by market operators. The effectiveness of these reviews in identifying member non-compliance reinforces the importance of ensuring all market operators have proportionate and effective arrangements in place.
- Our rules and guidance – in REC and MAR 5 – impose ongoing responsibilities on market operators to assess the adequacy of members' arrangements. It is important we set out our recommendations for market operators to comply with these responsibilities, so there is more consistency in the interpretation and approach.
- We received five responses to the consultation, which were generally supportive. The main issues raised were:

1. The need to consider the full set of oversight and control mechanisms used by the market operators

We have amended the guidance to be clear about the different elements of market operator oversight, i.e. all elements should be in place to ensure effective oversight, including on-boarding reviews, risk-based proactive reviews, and monitoring and surveillance controls.

2. Clarity on the status of the guidance and particular regulatory provisions from which this guidance is drawn

While this guidance sits outside the Handbook, it nonetheless contributes to the FCA's view of the elements that should be in place to ensure compliance with our rules in this area.

Our draft guidance referred to obligations for market operators under MAR 5.5.1R(1) and REC 2.6.27 (G). Feedback from consultation suggested we should expand the references to Handbook provisions, especially where we are considering the full range of tools used by market operators for effective oversight.

So we think it is relevant for market operators to consider obligations firstly under MAR 5.5.1R (1), and REC 2.15.1(1)(a), which both focus on members' compliance with market operators' rules. Further relevant provisions relating to investor protection and market abuse include MAR 5.5.1R (2), REC 2.6.27G (1) and (6), REC 2.6.28 (G), and REC 2.10.

3. Coordination between market operators

We appreciate there may be overlap between members of different trading platforms, and that there may be situations where a member has more than one review proposed at a time. In this situation we would expect market operators to take a pragmatic approach to their review timetable.

4. Reliance on members' compliance with related regulatory obligations

Each platform has its own rules and obligations it imposes on members. Moreover the obligation to assess compliance rests with each market operator. So we do not consider it appropriate for a market operator to rely on others' due diligence to determine compliance. The outputs of one review could be used to inform another review, but we expect the assessment to be independent.

- We have had follow-up conversations with four of the five respondents, as well as giving a presentation to the FCA's Practitioners' Surveillance Group, which represents a significant proportion of the trading activity on organised venues in the UK. We have encouraged market participants to share best practice and experience with each other, to ensure more effective reviews.

Final guidance

Contents

1. Here we give an overview of the approach we expect recognised investment exchanges (RIEs) and firms operating multilateral trading facilities (MTFs) to take to ensure ongoing oversight of the systems and controls which their member firms operate to comply with the RIE's or MTF operator's rulebook. This applies to RIEs operating MTFs as well as their RIE operations.
2. These obligations come from the FCA Handbook (at MAR 5 for MTF operators) and from the Recognition Requirements (as set out in REC 2.6, REC 2.10 and REC 2.15 for Recognised Investment Exchanges who operate a regulated market and MTFs).
3. This guidance is effective from the date it is published.
4. We are setting out the approach we expect because our supervision work showed that recognised investment exchanges and MTF operators are currently defining and implementing their oversight responsibilities very differently. We expect these arrangements to be proportionate to the nature of the business.

Background

5. As a consequence of discussions with RIEs and MTF operators (which we call 'market operators' here) about sponsored access and DMA, we saw significantly varying levels of knowledge of member firms' arrangements and controls for connecting to, and trading on, their platforms.
6. This made us take stock of the regulatory requirements relating to market operators' oversight and control of their members. We concluded there are three key elements to the obligations on market operators in this area:
 - i. effective risk assessment procedures at the time of approving and on-boarding new members
 - ii. ongoing arrangements to assess members' compliance with market operators' rules
 - iii. monitoring and surveillance arrangements to assess potential breaches of market operators' rules and market abuse
7. While we would expect some differences due to the nature of the platforms, membership, and products traded, we are now setting out our high-level expectations under these provisions.

8. All market operators should have in place effective and proportionate arrangements, with documented processes and procedures. They must be able to determine that their members' systems and controls can be reasonably expected to ensure compliance with the respective market operator's rules and trading procedures. The arrangements should cover both assessments of new members and ongoing arrangements for continued assurance.

Risk-based approach

9. We expect a market operator's monitoring system to be both proportionate and risk-based.
10. So a market operator may choose to concentrate its efforts on member firms that it deems to be riskier, or whose failure to operate adequate operational controls would have a bigger impact on the market than others (e.g. because of the nature or scale of the activity that the firm undertakes), while still ensuring that it exercises adequate oversight of other members that are deemed to pose less risk. It should base any assessment of the level of risk that each member poses on well-defined criteria; this could include the scale or complexity of the member's trading activity and whether the member has sponsored access or DMA clients. The platform operator could tailor the exact level of monitoring differently for each member and their platform.

Proactive approach

11. We expect a market operator's approach to be proactive and go beyond a reactive examination of member-level systems and controls failures once they have occurred. It is important that proportionate effort is made to engage with members before there is any evidence of system and control deficiencies. This engagement should enable a market operator to ascertain whether there is any non-compliance with rules, or a significant risk of rule breaches.
12. When a market operator discovers evidence of inadequate systems and controls amongst one of its members, we expect it to take appropriate and swift action, even if these have not yet had a negative impact on the market. Market operators have obligations in relation to enforcing compliance with their rules.

What does this mean for market operators?

13. As the UK authority responsible for supervising trading platforms, we will expect market operators to observe this guidance as recommending action to help them comply with their regulatory requirements.