

## Attachment 2 to Stock Exchange Notice N25/10

### DEFINITIONS

<b>direct market access</b>	a service provided by a <b>member firm</b> through which a <b>customer</b> is able to submit orders to the <b>trading system</b> under the <b>member firm's</b> trading codes and via the <b>member firm's</b> usual order management systems, but without manual intervention by the <b>member firm</b>
<b>sponsored access</b>	a direct technical connection that enables a non <b>member firm</b> to access the <b>trading system</b> directly under a <b>member firm's</b> trading codes. Orders submitted in this manner do not pass through the usual order management systems of the <b>member firm</b> but will pass through the <b>Exchange's</b> controls
<b>trading system</b>	the trading system operated by the <b>Exchange</b>

### CORE RULES

#### Notifications [1050-1051]

##### **Immediate notifications**

G 1050	A <b>member firm</b> shall, immediately upon becoming aware of any circumstances which have, will or may lead to a contravention of any of the rules, including system problems, notify the <b>Exchange</b> of such circumstances in as much detail as is available to it. Failure of a <b>member firm</b> to notify the <b>Exchange</b> in such circumstances may result in a contravention of the rules by the <b>member firm</b> .
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##### *Guidance to Rule:*

A **member firm** system problem is any in-house technical difficulty which prevents a **member firm** from accessing, viewing data from or submitting data to the **trading system**. Where a **member firm** provides **direct market access** to **customers**, a **customer** system problem may also constitute a notifiable event.

Such notifications should be made to the Market Supervision department on (0044) 20 7797 3666, STX 33666.

### ORDER BOOK TRADING RULES

#### **Order entry**

##### Access to the trading system and the responsibility of member firms [2100-2109]

G 2103	A <b>member firm</b> may allow a <b>customer</b> to submit orders to the <b>trading system</b> under the <b>member firm's</b> trading codes, either by way of <b>direct market access</b> or by providing <b>sponsored access</b> , subject to the <b>member firm</b> having in place adequate systems and controls.
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##### *Guidance to Rule:*

##### Direct market access and sponsored access

Submission of **customer** orders may be facilitated by either **direct market access** or via **sponsored access** to the **trading system**.

**Direct market access** is a service through which a **member firm** allows a **customer** to submit orders to the **trading system** under the **member firm's** trading codes and via the **member firm's** usual order management systems, but without manual intervention by the **member firm**. These order management systems may be housed within the **member firm's** facilities or hosted within the **Exchange's** Primary Data Centre but, importantly, are the same systems through which the **member firm** submits at least some of its own order flow to the **trading system**.

**Sponsored access** is a direct technical connection provided so that a **customer** is able to access the **trading system** under a **member firm's** trading codes. As the connection is direct, orders submitted by the **customer** to the **trading system** do not pass through the usual order management systems of the **member firm**.

**Exchange** level controls are provided within the **trading system** to assist **member firms** with **sponsored access** order flow validation. Orders submitted via **sponsored access** will pass through the **Exchange** level controls before reaching the **order book**.

Responsibility for **customers'** order flow (whether submitted to the **Exchange** via **direct market access** or **sponsored access**)

**Member firms** providing **customers** with **direct market access** or **sponsored access** to the **trading system** are responsible for all obligations and liabilities arising from the entry, deletion and execution of all orders submitted by that **customer**.

The **Exchange** is aware that **member firms** may have contractual arrangements with their **customers** that mean the **customer** bears the financial risks of entering erroneous orders. However, under the **Exchange's** Rules the responsibility for such orders rests wholly with the **member firm** under whose trading codes the order is entered.

The **Exchange** requires a **member firm** to be able to delete a **customer's** orders from the **trading system** or, if necessary, restrict the **customer's** ability to enter orders, without having the express consent of the **customer**. Such action by the **member firm** may be instigated unilaterally by the **member firm** because of its own concerns regarding the **customer's** behaviour or at the specific instruction of the **Exchange**.

The **member firm** is expected to adopt a regime where sufficient consideration is given to assess matters such as:

- the training that has been given to the individuals entering orders;
- the access controls over order entry that the **customer** applies;
- security controls over any network link between the **customer** and the **member firm**. These should be sufficient such that the **member firm** can be sure that an order purporting to come from a particular **customer** actually has done so (e.g. by use of authentication codes in a similar manner to the secure interactive interface linking the **member firm** to the **Exchange**); and
- clear allocation of responsibility for dealing with actions and errors (e.g. it should be clear how, when and by whom orders on the book would be deleted).

All of these matters should be dealt with in formal agreements between the **member firm** providing **direct market access** or **sponsored access** and its **customer**. (**Member firms** may provide **sponsored access** to non **member firms** only.)

**Direct market access**

Whilst ongoing education, training and guidance for a **member firm's** **customers** that submit orders through the **member firm** to the **trading system** are to be encouraged, these cannot entirely replace the safeguards that internal system controls and alerting functionality can provide.

In order to prevent the submission of erroneous orders by a **customer**, a **member firm** may wish to consider the following controls and system alerts:

- prevention of submission of an order if the **customer** has overridden alerts and/or notification to the **member firm** that the **customer** has attempted to over-ride the alert;

- the segregation of this order flow by the use of the Trader Group facility within the **trading system**;
- appropriate training, education and guidance provided to those **customers** entering orders;
- the need for order acknowledgements from the **customer**;
- controls over maximum order sizes that can be submitted by different **customers**;
- controls over prices of orders and having system parameters that would generate an alert if the order would execute at a price with which the **member firm** would not be satisfied; and
- monitoring and controls over the total exposure of the **member firm** to orders submitted for a particular **customer**.

### **Sponsored access**

The **Exchange** does not require **sponsored access** order flow to pass through the **member firm's** own systems and controls but mandates that all orders submitted via **sponsored access** pass through **Exchange** level controls before reaching the order book. **Member firms** should also assess whether any additional controls are necessary to appropriately manage **customer** order flow, taking into consideration the nature and complexity of its **customer's** business.

**Member firms** are responsible for determining the limits of the configurable **Exchange** level controls within the parameters provided by the **Exchange** and ensuring that they are appropriate for each individual **sponsored access customer**, based on the scope and scale of its business.

A **member firm** that provides this facility for a **customer** must:

- complete a **sponsored access** application form for each of its **sponsored access customers** and inform the **Exchange** if it becomes aware that the information provided on the form has changed;
- ensure that relevant staff at the **customer** are conversant with the Rules and, in particular, those relating to **order book** trading. Relevant staff include the Head of Trading, the Head of Compliance and person(s) who signs off trading algorithms at the **customer**;
- segregate each **customer's** order flow from the **member firm's** order flow using the Trader Group facility within the **trading system**. This is necessary to assist the **Exchange** in maintaining fair and orderly markets;
- provide the **Exchange** with the name, head office address and country of incorporation of the **member firm's customer** for regulatory purposes. This information will be treated as confidential and will not be subject to commercial use;
- have systems in place which will allow the **member firm** to accept and review drop copy feeds, on a real-time basis from the **Exchange** and monitor all **sponsored access** order and post-trade flow;
- proactively utilise the **Exchange's** kill switch facility to disconnect a **customer** which it has reason to believe is behaving inappropriately; and
- inform the **Exchange** and take appropriate action if it loses either its connectivity with the **Exchange** or its connection to the drop copy feed from the **Exchange** where that connection allows the **member firm** to monitor the **customer(s)** order and post-trade flow. The **Exchange** mandates the use of its cancel on disconnect facility. Where a connection is dropped by either the **member firm** or its **sponsored access customer**, all of the **sponsored access customer's** orders will be deleted from the **order book**.

(Amended N43/08 – effective 5 January 2009)

G	2104	A <b>member firm</b> must undertake due diligence on any <b>customer</b> to which it provides or intends to provide <b>sponsored access</b> , in order to assess the suitability of any such <b>customer</b> to have a <b>sponsored access</b> connection. The <b>member firm</b> must confirm to the <b>Exchange</b> that such due diligence has been undertaken.
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*Guidance to Rule:*

A **member firm** must have undertaken due diligence to confirm that any **customer** to which it provides **sponsored access**:

- is considered fit and proper to have a direct technical connection to the **trading system**;
- has appropriate financial resources;
- has sufficient staff with adequate knowledge, experience, training and competence for the activities the **customer** undertakes on the **Exchange's order books**. **Member firms** may wish to consider whether training should be provided to the Head of Trading, the Head of Compliance and person(s) who signs off trading algorithms at the **customer**; and
- has adequate internal procedures and controls for these activities notwithstanding the **Exchange** level controls provided for all sponsored order flow.

This assessment may fit within the **member firm's** existing due diligence framework or, if considered necessary, involve new due diligence processes that are specific to the provision of **sponsored access**. It is for **member firms** to judge what due diligence is necessary given the business, trading strategies and order flow of the **customer** or prospective **customer** to which the **member firm** wishes to provide **sponsored access**.

**Member firms** are required to confirm when submitting an application form that they have undertaken appropriate due diligence to be satisfied on each of the above points. The **Exchange** will exercise its right under rule 2105 to refuse **sponsored access** if it believes that the **member firm's** due diligence is inadequate.

Furthermore, **member firms** are required to satisfy themselves and, when requested, the **Exchange** that the **customers** to which they have provided **sponsored access** continue to meet these requirements. For instance, if a **customer** to which a **member firm** has provided **sponsored access** has a significant change in trading volumes or its trading model, the **member firm** may consider it appropriate to refresh its due diligence and/or the limits at which the **Exchange** level controls have been set for that **customer** to ensure that its systems, controls, training and staffing are adequate for its changed business. Otherwise, due diligence should be periodically reviewed according to the **member firm's** normal timetable, and the **Exchange** may require the **member firm** to share this reviewed due diligence with it. A **member firm** that becomes aware that a **customer** no longer meets the requirements must notify the **Exchange** immediately and cooperate with the **Exchange** to halt the **customer's sponsored access**.

(Amended N43/08 – effective 5 January 2009)

D G	2105	The <b>Exchange</b> reserves the right to refuse a <b>member firm's</b> request that a <b>customer</b> be provided with <b>sponsored access</b> to the <b>trading system</b> .
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*Guidance to Rule:*

The **Exchange** may refuse a request to provide a **member firm's customer** with **sponsored access** where the **Exchange** is not satisfied in any respect with the due diligence undertaken by the **member firm** or where, in the **Exchange's** view, provision of the connection would present a risk to the orderly functioning of the **Exchange's** markets. Whilst the **Exchange** does not conduct due diligence on **member firms' prospective customers**, it may refuse a request to provide a **member firm's customer** with **sponsored access** where it is aware of adverse information about the prospective **customer** which may not have been detected by a **member firm's** due diligence;

The **Exchange** may also, at its own discretion, take other factors into account in applying this rule. The **Exchange's** view of the risks that may be posed by the provision of **sponsored access** to a **member firm's customer** overrides any contrary view taken by the **member firm**.

(Amended N43/08 – effective 5 January 2009)

D	2106	The <b>Exchange</b> reserves the right to terminate or suspend a <b>customer's sponsored access</b> without notice or consultation with the <b>member firm</b> or its <b>customer</b> where the <b>Exchange</b> believes this is necessary to preserve the orderly functioning of the <b>Exchange's</b> markets.
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(Amended N43/08 – effective 5 January 2009)

D	2107	The <b>Exchange</b> reserves the right to restrict or segregate a <b>member firm's</b> access to and use of the <b>trading system</b> as it sees fit.
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*Guidance to Rule:*

The **Exchange** may decide to segregate a **member firm's** access to and use of the **trading system** in order to protect market orderliness or for other regulatory reasons.

Whilst the **Exchange** does not mandate how a **member firm** should segregate its **order book** business at **trader group** level, the **Exchange** reserves the right to do this as it sees fit. Typically, this would be where it suspects a **member firm's** controls to be inadequate or inappropriate, or, more generally, where it considers this to be in the interest of maintaining a fair and orderly market.

For instance, where a **member firm** chooses to use only one or a limited number of **trader groups** for its order flow, and the **member firm** has repeated problems in relation to erroneous orders being entered by **direct market access customer**, the **Exchange** may require that all orders from that **customer** are assigned to a specific **trader group**.

(Amended N43/08 – effective 5 January 2009)