

153

Financial Services Authority

Alternative trading systems

October 2002



Contents

1	Executive summary	3
2	Introduction	6
3	Scope and timing	11
4	Standard-by-standard proposals	16
5	Statutory requirements	28

Annex A: Cost-benefit analysis

Annex B: Compatibility with our general duties

Annex C: CCSR Standards and selected commentary

Annex D: Glossary

Annex E: List of questions

Annex F: Proposed Handbook text

Copies of this consultation paper are available for download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 31 January 2003.

You can send your response by electronic submission using the form on our website (at www.fsa.gov.uk/pubs/cp/cp153_response.html), by e-mail (cp153@fsa.gov.uk) or in writing to:

Laurence White
Markets and Exchanges Division
The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7676 3354

Fax: 020 7676 3355

It is our policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. The names of all respondents will be published.

1 Executive summary

- 1.1 Alternative Trading Systems (ATs) have risen in importance in several securities markets around the world, as an alternative to traditional exchanges. The UK has been no different, and today is host to around 25 ATs, active in markets for equities, bonds, financial derivatives and commodities.
- 1.2 They are currently subject to the same UK regulatory regime as applies to all securities firms. The regime is not tailored for their kind of operation, which is somewhere between that of an exchange and an ordinary firm. By contrast, jurisdictions around the world have introduced regulatory changes designed to deal specifically with ATs, either as a separate category or as part of a wider ‘marketplace’ concept.
- 1.3 In January 2000, partly prompted by these developments, we issued a Discussion Paper on the regulation of market infrastructure providers (MIPs). That paper discussed issues that might arise from market trends such as the emergence of electronic trading platforms and their impact on the markets in which they operate. We sought views on several possible courses of action, and other ways in which it might be necessary to revise our regulatory regime for MIPs to respond to market developments.
- 1.4 Responses to the Discussion Paper urged us to concentrate our efforts in the European arena rather than to act unilaterally. In line with these comments, we chaired the ATs Experts Group of the Committee of European Securities Regulators (CESR).¹ The Experts Group began its work in 2000 and proceeded through two consultations to publish its final Standards for ATs in July 2002.
- 1.5 This Consultation Paper sets out our proposals for implementing the CESR Standards for ATs. The text of the Standards and selected commentary is set out in Annex C. We are seeking input from firms, trade bodies and other interested parties, in a consultation that finishes at the end of January 2003.

¹ previously, the Forum of European Securities Commissions (FESCO)

- 1.6 Our proposals for implementing the Standards are discussed in Chapters 3 and 4, and are set out as proposed Handbook changes in Annex F. Broadly speaking, we propose to:
- issue clarifying guidance on the need for ATs to provide us with material information and provide satisfactory clearing and settlement arrangements;
 - require ATs operators to facilitate fair and orderly trading on their system, make details of prices and trades publicly available, monitor user compliance with trading rules, and have arrangements to detect and report abusive trades;
 - require ATs operators to give specified information to private and intermediate customers about their systems; and
 - require ATs operators to provide, or satisfy themselves there is publicly available, information about securities traded on their system.
- 1.7 We are also consulting on an option for implementing some of the Standards by using our powers to impose requirements on firms' Part IV permission² instead of using rules and guidance. One potential advantage of this course is that it allows us the flexibility to tailor requirements to particular systems.
- 1.8 In this paper we also consult on the correct scope of the regime, in terms of type of legal entities, instruments traded, territorial aspects and the definition of ATs. In our implementation proposals, we are seeking to build on the foundations laid by CESR, but with a close eye on our domestic market structure and regulatory regime as well as the forthcoming revision of the Investment Services Directive (ISD).
- 1.9 We recognise that our proposed regime would impose some costs on ATs. However, we think those costs would be manageable and we do not believe they would place ATs at a material disadvantage to their competitors: exchanges, voice brokers, overseas firms and the like. Most importantly, we think there would be significant benefits in terms of greater use of ATs, increased competition between ATs and other execution venues and between intermediaries, and other benefits. We believe these benefits would outweigh the costs.
- 1.10 We will formulate our final proposals in light of responses to this Consultation Paper and ongoing ISD developments. At this stage we anticipate issuing final text in May 2003, with Handbook provisions to come into effect in August 2003. However, we are consulting on this implementation timetable, and may need to delay the coming into effect of at least some of the Standards to enable firms to comply.

2 i.e., their permission to carry on regulated activities under Part IV of the Financial Services and Markets Act 2000 (FSMA)

Consumers

The ATs we are aware of in the UK deal principally with non-private customers, i.e. with intermediate customers and market counterparties. So, we do not expect the Standards to be of direct relevance to retail consumers and consumer groups. We do however think that implementing the Standards will support our consumer protection objective. Further details are in Annex B (Compatibility with our general duties).

2 Introduction

Background

- 2.1 The last decade has seen the development of a wide range of alternative trading systems (ATs) in many of the world's main financial markets. These new platforms have been made possible by rapid advances in information technology. This has enabled the creation of new market places which have no need for physical trading floors. As such, they can be readily accessed from anywhere in the world, can handle large trading volumes in an orderly manner, and link seamlessly into back office and settlement processes.

Risks to our objectives posed by ATs activity

- 2.2 We have attempted an analysis of comparative volumes figures in the respective major markets for exchange traded, ATs and traditional over the counter (OTC) activity. This is difficult, as ATs and OTC volumes are not regularly and consistently collected and published, either by participants or by regulators.
- 2.3 Our research shows that the importance of ATs varies significantly between different major markets. In equities, for instances, ATs volumes are not very significant compared with on-exchange activity. In the bond markets they are not very significant compared with OTC trading, but they are significant compared to the limited exchange trading. On the other hand, ATs facilitate the majority of trading in the repo and spot FX markets, and facilitate significant proportions of the gas, power and metals derivatives markets.
- 2.4 In Chapter 5 we state that our proposals are compatible with all four of our regulatory objectives.³ But in particular, we think that ATs under present

3 Our regulatory objectives under FSMA are:

- **market confidence**, i.e. maintaining confidence in the financial system;
- **public awareness**, i.e. promoting public understanding of the financial system;
- **consumer protection**, i.e. securing the appropriate degree of protection for consumers; and
- **reduction of financial crime**, i.e. reducing the extent to which it is possible for a business carried on by a regulated person, or in contravention of the general prohibition, to be used for a purpose connected with financial crime.

regulatory requirements pose risks to our market confidence, consumer protection and reduction of financial crime objectives.

- 2.5 The main risks to the market confidence objective posed by ATs under the present regime are from:
- little public transparency of ATs activity leading to possible inefficiencies in the price formation process and so higher trading costs;
 - variations in the extent to which operators comply with good practice in systems and controls, the monitoring of user activity, and arrangements for reporting of suspect transactions; and
 - the possibility of traders trading in transparent markets on the basis of information from trades only known to direct users of non-transparent ATs, to the disadvantage of participants in the wider market.
- 2.6 The main risks to consumer protection are from:
- difficulties for clients in asserting their rights to best execution where some activity is conducted on non-transparent ATs; and
 - variations in the extent to which operators provide system and investment information, including clarity about clearing and settlement arrangements, leading to the possibility of consumers⁴ mis-buying ATs services.
- 2.7 The main risk to the reduction of financial crime objective is the lack of transparency of ATs trading, and the lack of a systematic approach to the monitoring and reporting of suspect transactions.

Responses in other jurisdictions

- 2.8 ATs, many of which have the basic trading characteristics of an exchange market, have posed new issues for securities market regulators in many countries. The fundamental issue has been the appropriate way to modify regulation to underpin market integrity and investor protection. In addressing this issue, regulators have also been conscious of the need to mitigate risk in a way that does not discourage innovation and fair competition.
- 2.9 A number of countries have already introduced regulation in this area. Their approaches are summarised in table 2.1.

⁴ As used in FSMA, the term 'consumer' is not limited to retail investor and broadly covers any (potential) consumer of a financial service.

Table 2.1 Regulatory responses to ATs in selected jurisdictions

Country	General approach	Instruments
Australia	A single category 'financial market' covering exchanges and significant ATs	Qualifying financial products
Canada	Unified market-place concept, with exchanges and ATs subject to similar regulation in some areas (e.g. transparency)	Exchange-traded securities and government and corporate debt
Hong Kong	Flexible approach with transparency standards in particular tailored to the AT	Securities and futures
US – SEC	Incremental regulation, geared to market share	Equity and non-governmental fixed income
US – CFTC	Single market category with three tiers of market, according to degree of retail investors and manipulability of product	Financial and commodity derivatives

CESR Standards for ATs

- 2.10 We initiated a public discussion on AT regulation in a Discussion Paper, *The FSA's approach to regulation of the market infrastructure*, published in January 2000. In that paper, we floated the idea that, in broad terms, we should take a more functional approach to the regulation of market infrastructure providers (MIPs) and tailor regulation to the characteristics of each asset class.
- 2.11 Responses to the Discussion Paper urged us to ensure that development of UK regulation for MIPs took proper account of cross-border issues and the development of parallel regulation in the EU. With that in mind, we decided that we would not bring forward specific proposals for the UK at that time but first focus our attention on contributing to the development of policy at the EU level.
- 2.12 The predecessor body to the Committee of European Securities Regulators (CESR) set up an Experts Group in 2000 to develop Standards for ATs that member regulators could agree to implement ahead of the revised Investment Services Directive (ISD). CESR published draft Standards in June 2001 and revised proposals in January 2002. It issued its final *Standards for Alternative Trading Systems* (the CESR Standards) in July 2002.

- 2.13 The text of the CESR Standards and selected commentary is in Annex C. The Standards broadly address:
- issues relating to ATS operators, such as keeping regulators informed about ATSS, systems standards, and clearing and settlement arrangements (Standards 1, 6 and 7);
 - issues relating to trading on an ATS including transparency, monitoring and reporting of trading (Standards 2–5); and
 - issues relating to customers of ATSS including providing information about ATSS and about securities traded on them (conduct of business issues (a)–(c)).
- 2.14 At this stage, we are not aware of any other regulators that have implemented the CESR Standards by changing legislation. However, a number of other regulators have told us that they are proceeding to implementation, or are actively investigating whether there is a need to implement the Standards against the background of their existing provisions.

Purpose of paper

- 2.15 In this Consultation Paper, we set out our proposals for firms operating ATSS and describe in detail how we think the CESR Standards should be implemented in the UK. We welcome comments from all those directly affected by the proposals as well as other interested parties, including exchanges and investor groups. We would be grateful if respondents could concentrate on our questions in their responses, but we are also happy to receive comments on the issues raised more generally.
- 2.16 In determining our proposed response to the Standards, we have taken care to compare each Standard with existing relevant Handbook material. In some instances, we propose no changes since the Standard is sufficiently covered. In others, we seek to build on existing Handbook material.

Structure of paper

- 2.17 Chapter 3 tackles a number of issues relating to the scope and timing of our proposals.
- 2.18 Chapter 4 addresses the CESR Standards in detail and sets out our proposals for implementing each Standard (or our reasons for thinking no change is necessary).

2.19 Chapter 5 discusses the costs and benefits of implementing the ATS regime and why we think, on balance, the benefits of the proposed regime as a whole, would outweigh the respective costs. It also describes the compatibility of the ATS regime with our regulatory objectives and the principles of good regulation.

3 Scope and timing

Scope

Instruments

- 3.1 The CESR Standards apply to ATs facilitating trading in financial instruments within the ISD (ISD instruments). However, CESR left open the possibility of national regulators extending the scope to commodity derivatives.
- 3.2 We propose to apply the ATs Standards to entities operating ATs that facilitate trading in most designated investments (broadly, ISD instruments and commodity derivatives), but not other kinds of investment⁵ such as rights under contracts of insurance.
- 3.3 We think that commodity derivatives should be covered. We believe ATs facilitating trading in commodity derivatives present similar levels of risk to our regulatory objectives to those presented by other kinds of ATs. Given that we regulate commodity derivatives exchanges and the wider trading in those derivatives, we see no good reason to exclude such ATs from the Standards. This conclusion is borne out by our cost-benefit analysis (see Chapter 5).

Operating entities

- 3.4 The CESR Standards apply to investment firms and to ‘other entities which are authorised to provide investment services, such as credit institutions’.⁶
- 3.5 We propose to cover firms authorised under FSMA (including service companies, credit institutions and other firms) operating an ATs as defined. We do not propose to cover exempt entities such as recognised investment exchanges (RIEs).

⁵ i.e., specified investments as defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, Statutory Instrument No. 2001/544, as amended (the RAO)

⁶ Footnote 2 to the CESR Standards.

- 3.6 We propose to adopt this scope because we do not believe a platform facilitating trading in, say, credit derivatives that is operated by a credit institution would present materially different risks to our objectives than the same platform operated by a securities firm.
- 3.7 By contrast, we think there are a small number of service companies⁷ that operate ATs within our proposed definition. We think that service companies operating ATs do not pose significantly different risks to our objectives simply by being service companies, although in practice such firms tend to be fairly low-risk on our impact and probability metrics.
- 3.8 As there are some service companies that operate ATs on the CESR definition, there are three options for dealing with them:
- exempt service companies from the ATs Standards;
 - require such companies to become ordinary firms and subject them to full conduct of business regulation plus the ATs Standards;
 - impose the ATs Standards on such firms without otherwise changing the regime that applies to them.
- 3.9 The last option is the one we are consulting on. We think the first option might encourage ATs operators to restructure as service companies. We think the second would be an overreaction to the risks posed.
- 3.10 On our proposals for implementation, some of the ATs Standards would be imposed on firms that operate ATs through new provisions in the *Conduct of Business sourcebook* (COB 1.2 and 4.2) and in Chapter 3 of the *Market Conduct sourcebook* (MAR 3). These provisions do not currently apply to service companies. So, we would have to amend the application provisions of COB and MAR 3 to ensure that, to the extent necessary to comply with the Standards, both those sets of provisions apply to service companies. Many of the Standards would, on our proposals, be imposed under MAR 5, which would also apply to service companies operating an ATs.
- 3.11 Broadly speaking, the same options present themselves for ATs operators who happen also to qualify as energy market participants or oil market participants. We propose a similar approach to such firms that operate ATs as we propose for service companies.

Territorial scope

- 3.12 CESR has stated that the market-facing Standards (i.e., Standards 1–7) should be applied on a home state basis. Our draft Handbook text implementing

⁷ Service companies are firms which are permitted only to make arrangements with a view to transactions in investments, within article 25(2) of the RAO, and to agree to carry on that activity. They also have certain standard restrictions on their permission, such as the inability to hold client money and to approve financial promotions for others.

those Standards will ordinarily have this effect. The only exceptions are unusual cases dictated by the strict legal effect of the E-commerce Directive. We plan to take a similar approach to firms based outside the EEA as to those based in other EEA states.

Q 3.1 Do you agree with the proposed scope of the ATS regime?

Q 3.2 In particular, do you agree with the proposed treatment of service companies and commodities firms?

Definition of ATS

- 3.13 We have not built territorial scope into the definition of ATS, other than by requiring that the operator of the ATS be a ‘firm’, i.e. an entity authorised under FSMA. Obviously, this excludes entities that do not need to be authorised in the UK because they are exempt (such as RIEs). Importantly, it also excludes firms making use of the overseas persons exclusion in article 72 of the RAO. This exclusion, broadly, relieves overseas persons from the need to be authorised under FSMA when conducting what would otherwise be regulated activities in the UK, in certain circumstances.
- 3.14 In defining an ATS, we have chosen not to define further the key terms ‘system’ and ‘operate’, preferring to let them bear their ordinary meaning. Our thinking here has been to leave a degree of flexibility open, since if the definition is too specific, it may not be capable of being applied to future developments.
- 3.15 We also propose to adopt CESR’s own guidance on the definition of an ATS to clarify for firms whether or not they will be covered by the definition. At this stage we do not propose to reproduce CESR’s guidance table of different kinds of systems, as we think it is already adequately covered in the definition and the guidance text itself.

Q 3.3 Do you have any comment on the proposed definition of ATS and its accompanying guidance?

Voice brokers

- 3.16 Trading on an ATS is only one way in which trading interests of a variety of parties can be brought together. In many markets, traditional telephone trading is still prominent, despite technological advances that would allow movement of a large proportion of this trading activity onto an electronic platform. The key players in the traditional phone trading market are the so-called voice brokers.
- 3.17 Many operators of ATS and, indeed, exchanges regard voice brokers as a significant competitive force. They argue that voice brokers provide the same kind of services as they do and that the only distinguishing feature is

technology. So, the view expressed by some ATS operators and other market players is that voice brokers should be subject to similar standards as those proposed in this paper for ATSs. Other market players express the opposite view and argue that voice brokers can be clearly distinguished from ATSs.

- 3.18 Some voice brokers operate computerised bulletin boards or screens that are used to disseminate trading interests appearing on their order books to their clients. Clients with access to the bulletin boards or screens can then ring up the voice broker to place or accept orders or other interests. The voice broker will then update the screen to reflect the client's instructions. Other voice brokers go one step further and allow direct client access to the screen, allowing clients to post or hit orders directly.
- 3.19 In carrying out our research for this paper, we applied a general approach to distinguish voice brokers from ATSs: where a broker allowed direct client access to its system, it would be counted as an ATS.
- 3.20 However, it might be considered that a voice broker operating a bulletin board to disseminate current positions would be covered by the definition of ATS, even in the absence of direct access. This is because in such an operation, the voice broker would ordinarily have no discretion as to how interests interact (although there may be some discretion whether to enter interests on the system).

Q 3.4 How, if at all, do you think ATSs should be distinguished from voice brokers?

Timing and related policy processes

- 3.21 Consultation on this paper runs until the end of January 2003. We propose to issue any final rules early in May 2003, coming into force in August 2003.
- 3.22 This timetable would give firms three months to comply with the Standards. We accept that some firms might consider that this timetable should be lengthened for some Standards, particularly where there is a need to implement systems changes. Our cost-benefit analysis assumes that in order to comply with the proposed timetable, firms may need to employ IT and compliance consultants rather than rely purely on in-house resources.
- 3.23 We also considered the issue of timing carefully in the context of the proposed revision of the ISD. There is some uncertainty over the timetable for the revision of the ISD, but the likelihood is that the final wording of a revised ISD will not be settled for some considerable time. We propose to implement the Standards next year, however, believing that there are present risks that require addressing.

- 3.24 We recognise that there are risks involved in this approach, but believe that issuing this Consultation Paper now will allow respondents to consider the proposals in the light of the formal draft of a revised ISD. We expect the European Commission (EC) to issue the draft before the end of this year.
- 3.25 We think that careful monitoring of progress in the EU context should allow us to ensure that firms affected by the proposed new UK regime will not be subject to two significant changes to the regulatory regime applying to them. Instead, we hope to achieve a seamless transition, which means that firms subject to the UK regime will automatically meet the requirements the UK would have to implement under a revised ISD.

Transparency

- 3.26 In our proposals for implementation of the transparency provisions, we have left the requirements as flexible and open as possible. This will allow us to take account of the continuing European discussions in this area and take the specific characteristics of the different systems into account.
- 3.27 Given our active involvement in the CESR Experts Group on Market Transparency and Efficiency, we will be able to monitor developments in this area closely. We will need to consider on an on-going basis whether any of the developments in the context of this CESR work should feed into the finalisation of our regime for ATs.
- 3.28 While the CESR Standards impose transparency requirements on ATs in wider asset classes, the current proposals of the EC for the revision of the ISD restrict transparency to equity instruments. In this paper we propose to implement transparency requirements for ATs facilitating trading of instruments traded on EEA exchanges, not just for those trading equity instruments. We do not believe that the risks to our objectives in the equities market are materially different than those posed in others.

Q 3.5 Do you have any comment on the proposed timetable and its links with related policy processes?

4 Standard-by-standard proposals

Introduction

- 4.1 In this Chapter, we take each Standard (or conduct of business issue) in turn and set out our proposals, where we are proposing changes to our Handbook. In the case of Standard 6, we have concluded that no change is necessary.
- 4.2 The full text of the CESR Standards, and selected CESR commentary, is set out in Annex C.
- 4.3 There are already provisions of the Handbook that are relevant in a general way to the issues addressed by the Standards. These provisions are found in:
 - *Principles for Businesses* (PRIN);
 - *Threshold Conditions* (COND);
 - *Senior Management Arrangements, Systems and Controls* (SYSC);
 - the *Authorisation manual* (AUTH); and
 - the *Supervision manual* (SUP).
- 4.4 Of particular relevance to some of the Standards are the following Principles:
 - Principle 2 – a firm must conduct its business with due skill, care and diligence;
 - Principle 3 – a firm must take reasonable care to organise and controls its affairs responsibly and effectively, with adequate risk management systems;
 - Principle 5 – a firm must observe proper standards of market conduct;
 - Principle 6 – a firm must pay due regard to the interests of its customers and treat them fairly;

- Principle 7 – a firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading; and
- Principle 8 – a firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

4.5 In relation to market counterparty clients of ATs (i.e., broadly, investment professionals), some of these Principles do not apply. The term ‘customer’ as used in the Principles excludes market counterparties, so Principles 6 and 8 do not apply. Principle 7 only requires communications to market counterparties to not be misleading (see PRIN 3.4.1).

Implementation options

- 4.6 In relation to ATS operators who engage only in inter-professional business with other market counterparties (and so would usually be covered by MAR 3), we considered implementing some of the Standards with guidance only, without the use of rules. However, we concluded that it is doubtful whether there are relevant principles (such as the Principles for Businesses) that we could use to underpin this guidance. This is largely because, as explained, where the clients are market counterparties, the relevant Principles do not apply, or only apply to a limited extent.
- 4.7 We considered extending the Principles so as to apply to market counterparty clients of ATs as a way of implementing some of the Standards. However we concluded this would not be a sufficiently specific way of implementing the Standards, and would in any case disturb the general treatment of market counterparties. For this reason we are not proposing this in our draft Handbook text.
- 4.8 It was also decided not to make operating an ATS a separate sub-activity of arranging deals in investments (art. 25 of the RAO) for Handbook and permission purposes. Creating such an activity would pre-empt the ongoing debate on this question in the context of the revision to the ISD. Implementing such a change would also introduce significant cost and administrative burden for us and for regulated firms.
- 4.9 In relation to the Standards discussed in this Chapter, we propose fairly high-level rules and general guidance. The rules and general guidance are drafted to reflect CESR’s discussion of the differentiation of Standards across different systems. We acknowledge that this may require us to give individual guidance in particular cases. In our proposed rules in MAR 5.4, addressing Standards 2–5 and conduct of business issue (c), we also make use of evidential provisions, which link a high-level rule to lower-level compliance obligations.

- 4.10 We are also consulting on an alternative version of MAR 5.4. This would contain guidance to the effect that we would be minded to impose requirements on ATS operators' Part IV permission⁸ under sections 43 (for new permissions), 44 and 45 (for existing permissions). These requirements would be designed to reflect the CESR Standards. The main advantage of this course is that the precise content of requirements could be tailored for particular firms, if necessary, while remaining legally enforceable and clear for firms. The primary drawback is that requirements are not transparent, either to consumers or to other firms, as they are not available on the Register. In theory, they could also lead to inconsistent treatment of firms similarly placed.

Standard 1: Notifications

- 4.11 This Standard requires notice to be given of new ATSs, information to be updated, and provides for statistics to be required by regulators.

Notification of new ATSs

- 4.12 For new applicants for Part IV permission who are proposing to operate an ATS, there is no need for substantive change, as the information required by the Standard is covered in the application pack.⁹ We also have powers under FSMA to require additional information, referred to in AUTH 3.9.13. The requirement to complete an application pack is brought to the attention of firms in proposed guidance in MAR 5.3.1G.
- 4.13 For existing firms proposing to operate an ATS who require a variation of their Part IV permission, we can require the firm to complete appropriate parts of the full application pack (see SUP 6.3). This will normally be the case where the application would cause a significant change to the firm's business or risk profile. We propose to clarify that this would ordinarily be triggered in MAR 5.3.2G.
- 4.14 For existing firms not needing to vary their Part IV permission to operate an ATS, SUP 15.3.8G requires firms to give us notice of any business expansion that would have a significant impact on their risk profile or resources. Again, in MAR 5.3.3G, we propose to clarify that this would be triggered for a firm that proposes to operate an ATS and that we may request further information from the firm at this point.

⁸ i.e., their permission to carry on specified regulated activities given under Part IV of FSMA

⁹ The application pack for new ATSs includes the systems form as a matter of course.

Updating information

- 4.15 Some of the information required to be updated by this aspect of the Standard would be updated in any case under existing SUP 15.3.8G. This requires firms to give us notice of certain changes which would have a significant impact on the firm's risk profile or resources. In proposed MAR 5.3.4G, we issue guidance specifically about giving notice of significant changes to the operation of the ATS. We have not sought to specify in the guidance the detailed list of topics mentioned in the CESR Standard, thinking this would be unnecessarily prescriptive.

Statistics

- 4.16 We do not think it appropriate to write a new supervision rule to require ATS operators to provide us with statistics. CESR has stated that regulators 'may' require this information. Our need for this kind of information will evolve over time and in the course of the supervisory relationship. We would expect firms to co-operate with our requests for statistical information as and when they arise.

Q 4.1 Do you have any comments on our proposals on Standard 1?

Standard 2: Fair and orderly trading

- 4.17 This Standard focuses on ensuring fair and orderly trading on ATs, including dissemination of pre- and post-trade information to direct users.
- 4.18 We do not believe the issues discussed by the Standard are currently specifically addressed in the Handbook. The issue of facilitating orderly trading, as opposed to fair treatment of customers, is not directly addressed by the Principles.
- 4.19 We are consulting on two preferred options for implementing the Standard:
- a high level fair and orderly trading rule together with evidential provisions and guidance reflecting the CESR Standard; or
 - guidance about imposing requirements on ATS operators' Part IV permissions under sections 43, 44 and 45 of FSMA in line with the Standard.
- 4.20 The proposed high-level rule (MAR 5.4.1R) is somewhat similar to the orderly business requirement in the *Recognised Investment Exchanges and Recognised Clearing Houses sourcebook* (REC). However, care has been taken to ensure that the rule, evidential provisions and guidance do not go beyond the CESR Standard, and are tailored to ATs. The provisions have been drafted to allow them to be applied in a differentiated way, depending on particular factors such as the nature of the system concerned.

- 4.21 As to the specific requirements in CESR's commentary, they are expressed as evidential provisions (MAR 5.4.2E) under the broader fair and orderly trading rule. As far as the requirement to provide information on orders and completed transactions is concerned, CESR has made clear that the extent of this requirement will depend on the type of users involved and the characteristics of the system. Added to that, for some systems, such as price-taking systems, it may not be appropriate to provide pre-trade information. This is reflected in proposed guidance (MAR 5.4.4G).
- 4.22 The second option consists of imposing requirements on Part IV permission (see MAR A5.4). For new firms, we would intend to impose the requirements on Part IV permission under section 43 of the Act. This section empowers us to include any requirements on permission we consider appropriate. For existing authorised firms, new requirements could be imposed under section 44 and 45(1) of the Act, where it appears that it is desirable to protect the interests of (potential) consumers. We consider that imposing Standard 2 through requirements would ordinarily satisfy this test.

Q 4.2 Do you have any comments on our proposals on Standard 2?

Standard 3: Publication of trading information

- 4.23 In contrast to Standard 2, this Standard relates to publication of pre- and post-trade information for the public and market as a whole.
- 4.24 The Handbook does not include provisions applying to firms that are directly relevant to the Standard. On the other hand, where firms that are exchange members trade on ATs, they may be under an obligation to trade report to the exchange under the exchange's rules, and the exchange may publish the trade. To this extent, a degree of post-trade transparency for ATs is already in place for some instruments.
- 4.25 The preferred options for implementation of the Standard are broadly the same as for Standard 2: a rule together with guidance, or requirements on Part IV permission embodying the CESR Standard.
- 4.26 The draft rule (MAR 5.4.5R) is similar to the Standard itself. The CESR commentary is reflected in the drafting of the rule to allow differentiation, and in the guidance on the rule: see proposed MAR 5.4.6G–9G. So, for example, the guidance states that publication of pre-trade information is unlikely to be appropriate for crossing networks.
- 4.27 We have limited the scope of the rule to instruments traded on an ATs that are also traded on EEA exchanges. This is not limited to regulated markets but includes commodities exchanges. So, some financial derivatives ATs in particular (whose instruments are not exchange traded) would not be covered

by the Standard. We will need to review whether this continues to be appropriate in light of developing proposals for a revised ISD.

- 4.28 As a second option, we have drafted guidance setting out that we would be minded to employ our powers to impose the transparency Standards by way of requirements on Part IV permissions of ATS operators (see MAR A5.4). Requirements that could be tailored to firms might be particularly useful in respect of Standard 3, where the precise content of the transparency requirement depend on so many factors.
- 4.29 We have not sought to translate the high-level principles in the CESR Standard into detailed rules for each type of instrument and system. We do not think this is appropriate, given the variety of ATS systems and the varying levels of transparency in each market. Where firms need additional clarity, we would be able to use our regulatory tools of individual guidance or more detailed requirements on permission, depending on which option is chosen.
- 4.30 CESR has made it clear that it favours ‘non-duplicative’ implementation of the Standards. So, the guidance allows for a choice of method for complying with the Standard (see MAR 5.4.7G). Where a trade is trade reported to an exchange and the price and volume is published by the exchange in a timely fashion (or exempt from immediate publication as a block trade), the post-trade transparency obligations would be discharged.

Q 4.3 Do you have any comments on our proposals on Standard 3?

Standard 4: Monitoring

- 4.31 Standard 4 requires firms to monitor user compliance with the contractual rules of the system. This is to be contrasted with Standard 5, which addresses market abuse, whether or not it amounts to a breach of the system’s rules.
- 4.32 The requirements imposed by Standard 4 are not covered in the Handbook.
- 4.33 We considered taking no action, but believe that this would inappropriately expose users of ATSS to the risk of poor practice on the part of system operators, and indirectly to the possibility of losses arising from trading in breach of system rules by other users of ATSS. System operators will usually, but not always, have adequate incentives to ensure that breaches of trading rules do not occur and are corrected.
- 4.34 The options proposed to implement the Standard are to reflect it in a rule with guidance (see MAR 5.4.10R and 5.4.11G), or to impose a requirement on Part IV permissions of ATS operators that reflects the Standard (see MAR A5.4).

4.35 The draft provisions are closely based on the CESR Standard. They recognise that what amounts to adequate monitoring will vary depending on the circumstances of the particular ATS. For example, closer monitoring may be required when retail users have direct access to the system or if the system plays an important role in the price formation process.

Q 4.4 Do you have any comments on our proposals on Standard 4?

Standard 5: Arrangements with regulators facilitating market integrity and investor protection

4.36 This Standard requires firms operating ATs to establish arrangements to facilitate satisfactory monitoring of the markets in the instruments traded and the detection of market abuse, where regulators require it.

4.37 A firm is already under an obligation to take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime: see SYSC 3.2.6G. However, this provision does not specifically address market abuse that does not amount to a financial crime as defined.

4.38 Principle 11 of the *Principles for Businesses* requires firms to deal with regulators in an open and co-operative way and to disclose to us appropriately anything relating to the firm of which we would reasonably expect notice. Again, this provision may not always require a firm to bring all the matters contemplated by the Standard to our attention.

4.39 One option considered was to extend SYSC 3.2.6, so that it applied to market abuse more generally. The advantage of this would be that it could apply both to existing firms operating ATs and new firms. Nevertheless, this alternative would be still not cover all the requirements. SYSC 3.2.6 does not address the element of the CESR commentary on supplying information to the home state regulator.

4.40 We also considered implementation by putting in place operating arrangements with firms operating ATs, similar to those in place between us and recognised investment exchanges on market misconduct. Such an alternative would be flexible and would allow us to work with firms on a 'firm-by-firm' basis. However, our operating arrangements with exchanges do not impose substantive obligations. They discuss how we will cooperate on enforcement issues where behaviour might amount to market abuse as well as a breach of an exchange's rulebook. As such, this option was not considered a suitable vehicle for implementing Standard 5.

- 4.41 Our two preferred options are:
- to make a new high level rule with evidential provisions and guidance; or
 - to impose individual requirements on Part IV permissions of ATS operators to similar effect.
- 4.42 The proposed draft rule, in MAR 5.4.12R, provides that an ATS operator must have arrangements in place to reduce the extent to which the system may be used for a purpose connected with market abuse. The evidential provisions in proposed MAR 5.4.13E then provide for:
- monitoring of the use made of a system;
 - detection of possible instances of market abuse; and
 - communication of information about suspected market abuse to us and other appropriate organisations.
- 4.43 The proposed provisions are modelled to some extent on the requirements on exchanges in relation to market abuse and financial crime in REC 2.10. The proposed requirements on Part IV permission in MAR A5.4 are drafted in a similar way to the proposed rule and evidential provisions.
- 4.44 The proposed Market Abuse Directive¹⁰ will be relevant for market operators offering trading in instruments that are admitted to trading on regulated markets. It sets out various systems requirements for market operators¹¹ and requires those professionally arranging transactions to notify regulators if they reasonably suspect market abuse.¹² We have drafted the alternatives so that, as far as possible, they will be in line with the proposed directive. This will avoid unnecessary further changes when the directive is implemented. We will keep developments in this sphere under review during the consultation period and when finalising our response to consultation.

Q 4.5 Do you have any comments on our proposals on Standard 5?

Standard 6: Systems

- 4.45 This Standard requires an ATS operator to be able to demonstrate that:
- the system is capable of delivering the proposed service;
 - there are satisfactory arrangements for the management of the technical operation of the system; and
 - there are satisfactory contingency arrangements in the event of system disruption.

10 Common Position on the draft Directive on Insider Dealing and Market Manipulation (Market Abuse) adopted by the Council of Ministers on 8 July 2002 (Common Position draft).

11 Article 6.6 of the Common Position draft.

12 Article 6.9 of the Common Position draft.

4.46 There are provisions in the current Handbook that fully address the issues raised by this Standard, so we propose no change. These existing provisions are:

- SYSC 3.1.1R, which states that a firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business;¹³
- SYSC 3.2.19G, which states that a firm should have appropriate arrangements, having regard to the nature, scale and complexity of its business, to ensure that it can continue to function and meet its regulatory obligations in the event of an unforeseen interruption;
- Threshold Condition 4, which requires a firm to have adequate resources to carry on its regulated activities; and
- Principle 3, which states that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

Q 4.6 Do you agree that the existing Handbook material adequately covers Standard 6?

Standard 7: Clearing and settlement

4.47 Standard 7 requires an ATS operator to ensure that there is clarity of obligations and responsibilities for the clearing (where applicable) and settlement of transactions.

4.48 While some Handbook provisions (notably, Principles 2, 3, 6 and 7) go some way towards addressing the Standard, they do not address the Standard specifically. We propose to:

- insert new guidance in the *Authorisation manual*. This will state that any applicant for Part IV permission who wishes to operate an ATS that will have private customers as users should provide sufficient information with its application to demonstrate that there are arrangements in place to ensure efficient clearing (where applicable) and settlement of transactions effected using the ATS (proposed AUTH 3.24.1G);
- require ATS operators that have private or intermediate customers to include information about arrangements for the clearing and settlement of trades in their terms of business (see proposed COB 4.2.17E); and

¹³ Firms should note that we are currently consulting (Consultation Paper 142 – Operational Risk Systems and Controls) on parts of SYSC.

- insert new guidance for ATSs that have market counterparties as direct users, stating that firms should consider giving similar information to their clients (proposed MAR 3.4.10AG).

Q 4.7 Do you have any comments on our proposals on Standard 7?

Conduct of business issues

- 4.49 In the remainder of this Chapter we discuss the additional material in section 2.2 of the CESR Standards, on conduct of business. This material was presented by CESR not as substantive Standards but as ‘its interpretation of the application of the disclosure requirements applying under existing conduct of business rules for those investment firms operating qualifying systems.’
- 4.50 In line with this, where possible in our proposals for addressing these issues we have made use of, or built on, existing conduct of business rules, to minimise the changes that firms would face. However, we do not think that all the issues raised are addressed by existing material, as discussed below.

Conduct of business issues (a) and (b): Clarity of relationship and system information

- 4.51 These issues state that ATS operators should make clear the nature of the relationship between operator and user, and should supply sufficient information about the system to enable a user to use the system efficiently and to understand any risks arising in using the system. In its commentary, CESR has stated that ATS operators should have agreements with clients and has specified a number of matters which should be made clear to ATSs clients.

Customers

- 4.52 Most operators of ATSs dealing with users that are private or intermediate customers are covered by COB 4.2 (Terms of business and client agreements with customers). COB 4.2 requires the provision of terms of business to the customer setting out the basis on which the firm is to conduct designated investment business with or for the customer. Provision of the terms of business referred to in COB 4.2 will ordinarily result in an agreement, as required by issue (a). So, we do not propose to amend COB 4.2 to address issue (a).
- 4.53 COB 4.2.15E details the contents of the terms of business provided to customers. However, COB 4.2.15E does not contain the same details as those in issue (b). So, we propose to supplement the terms of business with a further table of information addressing the matters in issue (b). This table (in proposed COB 4.2.17E) would be an evidential provision relating to COB 4.2.10R and 4.2.11E, requiring sufficient information to be given to customers.

Market counterparties

- 4.54 As noted above, Principle 7 requires only that communications to market counterparties not be misleading. There is no positive obligation to provide market counterparties with particular information.
- 4.55 We think guidance in MAR 3 (Inter-professional Conduct) already fully addresses issue (a) for relationships within its scope (broadly, between ATs and market counterparty users). MAR 3.4.10G states that firms should take reasonable steps to ensure that the nature of the capacity in which the firm is acting is clear to market counterparties e.g. as a principal, agent or arranger. We are satisfied that in practice it is inevitable that ATs will have agreements with market counterparty users. We therefore do not propose any change to MAR 3 to address issue (a).
- 4.56 To address issue (b), we propose new guidance in MAR 3 (see proposed MAR 3.4.10AG). This would state that an ATs operator should take reasonable steps to ensure that the responsibilities of the firm and the market counterparty in the use of the ATs are clear. It would also state that an ATs operator may wish to consider whether some, or all, of the information required by COB 4.2.17E for private and intermediate customers should be given to market counterparties. It should be noted that MAR 3 would keep its guidance status and the cross-reference to COB is not intended to alter the status of MAR 3 as guidance.

Service Companies, Oil Market Participants and Energy Market Participants

- 4.57 COB 4.2 does not apply to service companies, oil market participants and energy market participants.¹⁴ MAR 3 does not apply to service companies.¹⁵ With regard to service companies, oil market participants and energy market participants operating ATs, we propose to apply COB 4.2 to the extent necessary to address the issue with regards to their activities as ATs operators: see proposed COB 1.2.1R(2A) and 1.6.12R. We also propose to apply the new guidance in MAR 3 to service companies: see proposed MAR 3.1.1R.

Transitional provisions

- 4.58 In respect of the proposed changes to customer information requirements, we propose transitional provisions so that the requirements will only apply to new customers (see Part 2 of Annex F).

Other options

- 4.59 In addition to the proposals detailed above, we considered and rejected other ways in which issues (a) and (b) could be addressed:

¹⁴ See COB 1.2.1R(2) and COB 1.6.6R – COB 1.6.11G.

¹⁵ See MAR 3.1.1R.

- applying COB 4.2 to market counterparties. COB 4.2 does not currently apply to customers who are market counterparties and it would be inconsistent with the light touch approach in MAR 3 to apply COB 4.2;
- writing further guidance in MAR 3 requiring firms to enter into written agreements with market counterparty clients. We consider this unnecessary, since as stated we think it inevitable that ATs will have agreements with users.

Q 4.8 Do you have any comments on our proposals on conduct of business issues (a) and (b)?

Conduct of business issue (c): Publicly available information

- 4.60 This issue states that ATs operators should provide, or be satisfied that there is access to, sufficient publicly available information to enable users to form an investment judgement, taking into account both the nature of the users and the type of instruments traded.
- 4.61 The issue is not directly addressed in the Handbook. As a consequence, we propose a new rule requiring firms to provide, or be reasonably satisfied that users have access to, enough publicly available information to enable them to make a reasonably informed investment judgement about the value of each investment traded on the system. This must also allow them to make a reasonably informed judgement about the risks associated with that investment: see proposed MAR 5.4.15R.
- 4.62 The accompanying guidance goes on to say that users will usually be taken to have access to enough publicly available information about an investment if the investment is admitted to trading on an exchange and is not suspended from trading.
- 4.63 As an alternative, we are also consulting on the application of an equivalent requirement on a firm's Part IV permission which we would be minded to impose under sections 43, 44 or 45 of FSMA: see MAR A5.4.
- 4.64 For ATs offering facilities for dealing in unlisted investments to users that are private or intermediate customers, the proposed table of terms of business (see para 4.53) would contain additional information addressing some of the matters discussed in issue (c): see COB 4.2.17E(8) and (9).

Other options

- 4.65 In addition to the proposals detailed above, we considered making a rule requiring trading in securities to be limited to securities in which there is a proper market. We felt this would go well beyond the CESR issue and raise potentially complex issues.

Q 4.9 Do you have any comments on our proposals on conduct of business issue (c)?

5 Statutory requirements

Costs and benefits

- 5.1 Annex A contains our detailed cost-benefit analysis of the imposition of the Standards.
- 5.2 The main benefits we foresee from implementing the Standards are:
- greater use of ATs generally, arising from increased confidence among potential users that operators comply with good practice;
 - increased competition between ATs and between ATs and other execution venues (such as recognised investment exchanges or regulated markets);
 - greater competition between intermediaries on quoted spreads and on method and timeliness of execution;
 - an increase in informational efficiency, which will result in a lessening of trading in transparent markets on the basis of information about trades only known to direct users of opaque ATs;
 - an expanded market for order, quote and trade information and the consolidation of this information with similar information from other execution venues; and
 - a reduction in the risk of clients mis-buying ATs services and securities generally.
- 5.3 We think the main potential costs of implementing the Standards would be as follows:
- costs to ATs, in particular:
 - a) implementation costs; and

- b) potentially, costs associated with loss of business, as users who seek to continue to trade in secrecy move their business from ATs to other trading venues including voice brokers and trading platforms in offshore jurisdictions;
- user costs, particularly:
 - a) trading costs to firms (whether direct or indirect users of ATs) arising from potential ‘leakage’ of information about large positions to the market generally via transparency requirements and consequent market movements; and
 - b) possibly, higher trading costs arising from a reduction in liquidity on ATs, if there is significant diversion of order flow away from ATs and towards more costly execution platforms;
- potential market impacts, specifically:
 - a) a lesser number of trades conducted overall if trading costs (including costs arising from market movements) increase appreciably; and
 - b) diminished variety of services on offer as similar transparency and other standards lower service differentiation between ATs and between ATs and exchanges; and
- FSA costs including supervisory and policy costs.

5.4 For implementation costs to firms, we estimate the cost of the Standards for each firm as within the ranges £35,400–£187,000 one-off costs, and £15,040–£63,840 per annum. We consider the likely costs for commodities firms, service companies and other kinds of firms operating ATs to be similar.

5.5 On balance, we believe that the benefits of imposing the Standards would outweigh the costs.

Q 5.1 Do you have any comment on the cost-benefit analysis contained in Annex A?

The compatibility of the ATs regime with our general duties

5.6 Annex B contains a statement of why we think that imposing the Standards is compatible with our general duties, i.e. with our duties:

- to act, so far as is reasonably possible, in a way which:
 - a) is compatible with the regulatory objectives as set out in section 2 of FSMA; and

- b) we consider the most appropriate for the purpose of meeting those objectives; and
- to have regard to the principles of good regulation as set out in section 2.

Q 5.2 Do you have any comment on the compatibility statement contained in Annex B?

Cost-benefit analysis

Introduction

- 1 Cost-benefit analysis (CBA) assesses the economic costs and benefits of a proposed policy. In proposing new rules or general guidance on rules, we are obliged (under section 155 of FSMA) to publish a CBA, unless we consider that, making the appropriate comparison, there will be no increase in costs, or that any increase in costs will be of minimal significance. The appropriate comparison in this instance requires a comparison between the overall position if the rules are made and the overall position if they are not. The CBA should contain an estimate of the costs, and an analysis of the benefits, arising from the proposals. We seek to give quantitative estimates of costs, unless it is not reasonably possible to do so.

Benefits

- 2 We expect the main benefits of implementing the standards as proposed would be as follows.
- 3 We anticipate greater use of ATs generally. This would arise from increased confidence among potential users that operators comply with good practice in respect of systems and controls, the monitoring of user activity, arrangements for reporting of suspect transactions, clarity of clearing and settlement arrangements and provision of system and investment information. The standards relevant to this expected benefit are Standards 4, 5, 6, 7 and conduct of business issue (b).
- 4 We would anticipate increased competition between ATs and between ATs and other execution venues (such as recognised investment exchanges or regulated markets). This would arise from greater comparability of prices and spreads, and from greater awareness on the part of market participants and

end users of the different possibilities for execution. The relevant standards here are Standards 2 and 3.

- 5 Eventually, we expect greater transparency of ATSs to result in greater competition between intermediaries on quoted spreads and on method and timeliness of execution. This would lead to lower transaction costs to end users including retail investors. Again, the relevant standard here is Standard 3.
- 6 We also expect an increase in informational efficiency through a lessening of trading in transparent markets on the basis of information about trades only known to direct users of opaque ATSs. This trading is done at the expense of direct and indirect users of transparent venues who do not have access to prices discovered on such ATSs. We would anticipate increased trading volumes across execution platforms to the extent that investors would have minimised trade for this reason in the past. Note, however, that this benefit will be lessened to the extent that ATSs take advantage of block trading exceptions (see proposed MAR 5.4.8G). Relevant standards here are Standards 3, 4 and 5.
- 7 We expect ATS operators and financial information intermediaries and consumers to benefit from an expanded market for order, quote and trade information and the consolidation of this information with similar information from other execution venues. ATSs themselves will benefit from increased revenues arising from publication of trade information, where they use the option to make it available at commercial rates. We think such publication may also stimulate the provision of new data aggregation and intermediation services. Standard 3 is relevant to this benefit.
- 8 We believe that addressing the conduct of business issues will lead to a reduction in the risk of clients mis-buying ATS services and securities generally. This is because ATS operators will be required to provide standard information about their firms and services, and to ensure that investors have adequate access to information about traded securities. Conduct of business issues (a), (b) and (c) are all relevant here.

Costs

- 9 Costs arising from the proposals can be broken down into costs to ATSs, costs to users, market impacts, and our costs, as set out in more detail below.
- 10 Many ATSs already embrace all or some of the standards as good practice; to that extent costs already incurred are not attributable to the standards themselves.

Costs to ATSS

- 11 ATSS can be expected to incur some costs as a result of our proposals, in particular:
- **implementation costs**, i.e., changes to support the requirements on notification, publication of trading information, monitoring of improper trading activity, arrangements with the regulator, user agreements and publicly available information; and
 - potentially, costs associated with **loss of business**, as users who seek to continue to trade in secrecy move their business from ATSS to other trading venues including voice brokers and trading platforms in non-EEA jurisdictions.

User costs

- 12 There may be certain costs incurred directly by users associated with the proposals, including:
- trading costs to firms (whether direct or indirect users of ATSS) arising from potential 'leakage' of information about large positions to the market generally via transparency requirements and consequent market movements; and
 - potentially, higher trading costs arising from any reduction in liquidity on ATSS, if there is significant diversion of order flow away from ATSS and towards more costly execution platforms.

Market impacts

- 13 More generally, there may potentially be some negative market impacts, such as:
- a lesser number of trades conducted on ATSS if trading costs (including costs arising from market movements) increase appreciably; and
 - reduced variety of services on offer as similar transparency and other standards lower service differentiation between ATSS and between ATSS and exchanges.

FSA costs

- 14 We already supervise ATSS, but expect to incur additional costs in servicing the more detailed requirements to be placed on them as a result of our proposals. We expect our main additional costs to be in the areas of:
- policy support and revision in relation to implementing and maintaining the standards;

- determining the practical content of high-level arrangements (by way of tools such as individual guidance or requirements on a firm's Part IV permission) to supplement high-level rules, particularly transparency rules and arrangements with firms; and
- day-to-day supervision of new requirements, such as answering queries and correspondence, handling complaints and (if necessary) conducting investigations as to any breach of the requirements.

Estimate of costs

Size of sector

- 15 In part, arriving at an estimate of the costs and benefits of the proposed ATS regime depends on how large the sector is. The scope of the regime is, of course, a subject for consultation in this paper.
- 16 We believe there are around 25 ATSs currently under our supervision that are UK based that would be covered by the proposed regime. For the purpose of this CBA, this is what we take as the relevant group.

Quantifiable costs

- 17 We have estimated the implementation costs to firms associated with the standards, as well as the costs to ourselves. We set these out below in turn, analysed on a standard-by-standard basis. We base our figures on our best estimate of the additional costs, in terms of professional time and equipment,¹ taken to implement these standards. The additional assumptions we make in relation to these estimates are that: (a) our relevant ATS group incorporates commodities derivative firms; (b) impacts on all ATSs are broadly similar; (c) the effect of the requirements on permission and rules options as discussed in chapter 4 is the same. Assumptions we make are discussed further below.

1 For the purposes of these calculations, we have assumed the use of external contractors, with employee salary levels of £40,000 per annum for a compliance officer, £50,000 per annum for an IT consultant, and £60,000 per annum for a lawyer. To arrive at a per-diem rate for each of these contractors, we have assumed an overhead factor of 100% and a 250 day working year, as well as a total cost plus profit mark-up of 50%. Where we assume the use of in-house personnel, the 50% profit mark-up does not apply.

These assumptions give contractor per-diem rates of £480 per day $(= (£40,000 + (1.00 * £40,000)) * 1.5) / 250$ for a compliance officer, £600 per day for an IT consultant and £720 per day for a lawyer. For in-house staff, the assumptions give a per-diem rate of £320 $(= (£40,000 + (1.00 * £40,000)) / 250)$ for a compliance officer, £400 for an IT consultant and £480 for a lawyer.

18 We estimate the implementation costs to firms as follows:

Standard/issue	Narrative	One-off cost	Annual cost
1. Notification	<p>No major change is proposed to what already takes place as far as authorisation requirements and new systems are concerned.</p> <p>There may be minor costs associated with keeping us updated with changes to system details.</p>	-- ²	£640 ³
2. Fair and orderly trading	This is anticipated to represent existing good practice among ATS operators with minimal direct cost impact on firms.	--	--
3. Publication of trading information	<p>This may have a cost impact. IS systems may need re-engineering to provide for public transparency. There may also be costs associated with (re)negotiating arrangements with information intermediaries and with users to provide for the publication of this information.</p> <p>It is expected that ongoing maintenance of these arrangements would involve IS and compliance resources.</p>	£0 – £89,000 ⁴	£0 – £7,200 ⁵

2 In the table, '--' indicates that we estimate the cost as of no more than minimal significance.

3 Annual costs are estimated at two day's in-house compliance officer time per annum, for updating existing information only.

4 Estimated one-off cost of engineering a feed to a website or information intermediary, and (re)negotiating arrangements with information intermediary (where applicable) is up to 25 days of in-house IT consultant time, plus up to 50 days of contractor IT consultant time, plus up to 50 days of contractor compliance officer time, plus up to £25,000 equipment costs. Significantly lower figures could be expected where an ATS already provides a price and/or trade feed to an information intermediary or on a website, which merely requires 'tweaking'. Note that the cost will be zero where the ATS operator is exempt from transparency requirements, i.e. where instruments are not traded elsewhere on an EEA exchange (see proposed MAR 5.4.5R(1)).

5 Estimated at up to 10 days of in-house compliance officer time, and up to 10 days in-house IT consultant time. Note that no account is taken here of any offsetting receipts of feed fees from information intermediaries. Note again that the cost will be zero to the extent that the ATS operator is exempt from transparency requirements.

Table A.1 Implementation costs to firms (per-firm basis) *continued*

Standard/issue	Narrative	One-off cost	Annual cost
4. Monitoring of contractual rules	<p>We anticipate some relevant firms are already in a position to monitor compliance with contractual rules. There may in some cases be re-documentation costs associated with enabling ATS operators to take action (such as discontinuing access) against users for misuse of the system.</p> <p>There may also be annual costs associated with the compliance and legal functions so as to be able to monitor for and investigate breaches of contractual rules, where this does not already happen.</p>	£0 – £24,000 ⁶	£0 – £16,000 ⁷
5. Arrangements with regulators	<p>There are potential IS and compliance officer costs associated with installing software and systems to support this standard.</p> <p>There are also potential ongoing costs in terms of extra compliance officer time for identifying and communicating suspected market abuse matters.</p>	£21,000 – £50,000 ⁸	£6,400 – £25,600 ⁹
6. Systems	No change is proposed to existing Handbook material.	--	--

6 One-off costs are estimated at up to 20 days contractor legal time and up to 20 days contractor compliance officer time. Firms that already comply with the standard will incur zero costs.

7 Annual costs are estimated at up to 20 days in-house legal time and up to 20 days in-house compliance officer time. Firms that already comply with the standard will incur zero costs.

8 Estimated at 10 to 25 days in-house IT consultant time, plus 20 to 50 days of contractor IT consultant time, plus between £5,000 and £10,000 equipment costs. The lower figures could be expected where an ATS already provides a monitoring service under an arrangement with an exchange, which merely requires ‘tweaking’.

9 Estimated at between 20 and 80 days in-house compliance officer time. This would be mainly in administration of any monitoring and reporting system, and in the processing of notifications to us. Note that we would expect these costs to come about from the implementation of the MA Directive in any case.

Standard/issue	Narrative	One-off cost	Annual cost
7. Clearing and settlement	It is not anticipated that there will be material costs arising from implementation of this standard. The information aspect of this standard is covered in conduct of business issue (b) below. The systems aspect is already investigated as part of the permission process for new ATs.	--	--
Conduct of business issues (a) & (b) (Clarity of relationship and system information)	There will be minor one-off compliance costs arising from the need to make customers aware of certain details of the system. There will be annual costs relating to reaching agreement with new customers.	£4,800 ¹⁰	£1,600 ¹¹
Conduct of business issue (c) (publicly available information)	There may be some IS costs and compliance costs associated with the obligation, with respect to customers, to ensure or be satisfied there is sufficient publicly available information to enable users to form an investment judgement. There will be annual costs in maintaining and reviewing these arrangements.	£9,600 – £19,200 ¹²	£6,400 – £12,800 ¹³
Total per firm		£35,400 – £187,000	£15,040 – £63,840

- 19 On our estimate of 25 ATs, this gives a total one-off cost in the range £885K – £4.675M, and total annual costs in the range £376K–£1.596M.
- 20 We estimate our own costs¹⁴ as follows. Note that the following table contains only overall estimates, rather than per-firm estimates.

10 Estimated at 10 days contractor compliance officer time.

11 Estimated at 5 days in-house compliance officer time.

12 Estimated at between 20 and 40 days contractor compliance officer time.

13 Estimated at between 20 and 40 days in-house compliance officer time.

14 We use a per-day rate of £364 for FSA officer time, based on an hourly rate including on-costs of £52 per hour.

Table A.2 Implementation costs to the FSA

Standard/issue	Narrative	One-off cost	Annual cost
1. Notification	No major change is proposed to what already takes place as far as authorisation requirements and new systems are concerned. There may be minor annual costs associated with processing updated details.	-- ¹⁵	£3,640 ¹⁶
2. Fair and orderly trading	This is anticipated to represent existing good practice among ATS operators with minimal direct cost impact.	--	--
3. Publication of trading information	We will face policy and/or supervision costs associated with working out, for each ATS operator, precisely what transparency standards are expected, and annual costs in maintaining those standards for new and existing firms.	£7,280 – £14,560 ¹⁷	£3,640 – £7,280 ¹⁸
4. Monitoring of contractual rules	We do not anticipate material additional costs as a result of this standard.	--	--
5. Arrangements with regulators	There are potentially significant one-off and annual costs to us associated with this standard, particular in working out, and then supporting, arrangements with particular firms and in investigating and prosecuting referred matters.	£18,200 – £27,300 ¹⁹	£9,100 – £18,200 ²⁰
6. Systems	No change is proposed to existing Handbook material.	--	--

15 In this table, '--' indicates that we estimate the cost as of no more than minimal significance.

16 Additional costs are estimated at 10 days FSA officer time per annum.

17 Estimated one-off costs of working out more detailed standards on a firm-by-firm basis are between 20 and 40 days FSA officer time.

18 Estimated annual costs of working out and maintaining more detailed standards on a firm-by-firm basis are between 10 and 20 days, at £364 per day.

19 Estimated at between 50 and 75 days at £364 per day one-off costs.

20 Estimated at between 25 and 50 days at £364 per day annual costs. It is not anticipated that the volume of referred matters will be significant.

Table A.2 Implementation costs to the FSA *continued*

Standard/issue	Narrative	One-off cost	Annual cost
7. Clearing and settlement	It is not anticipated that there will be material costs to us arising from implementation of this standard.	--	--
Conduct of business issues (a) & (b) (Clarity of relationship and system information)	It is not anticipated that there will be material costs to us arising from addressing these issues.	--	--
Conduct of business issue (c) (publicly available information)	It is not anticipated that there will be material costs to us arising from addressing these issues.	--	--
Total		£28,000 – £52,500	£15,750 – £28,000

Unquantifiable costs and costs of no more than minimal significance

- 21 We have considered the other categories of cost discussed above. We believe they are not reasonably quantifiable, or that they will be of no more than minimal significance, as set out in the following table.

Category	Detail	Conclusion
Costs to ATSS	Loss of business	No more than minimal significance
User costs	Trading costs from information leakage	No more than minimal significance
User costs	Higher trading costs arising from a reduction of liquidity	No more than minimal significance
Market impacts	Lesser number of trades conducted	No more than minimal significance
Market impacts	Reduced variety of services on offer	Not quantifiable

- 22 As stated, we believe most of the above costs will be of no more than minimal significance. We are confident that we can seek increased transparency of ATSS on a case by case basis, such that operators' volumes (and so liquidity) are not materially affected. In part, we base our confidence on the experience of increasing levels of transparency on the UK equity markets in the 1990s, where despite fears to the contrary, there was not a significant flight overseas of order flow. We think that ATSS will continue to compete strongly with voice brokers on the grounds of efficiency, audit trail and general ease of use, and with exchanges on the grounds of simplicity and the un-bundling of the services provided by the traditional exchange venue. Similarly, block trading publication delays (which the standards allow for) will be important in not placing ATSS at a disadvantage to exchanges, and in not unduly prejudicing the ability of user firms to trade large positions without moving markets adversely. We think we will be helped in this endeavour through the flexibility, built into the CESR transparency standards, with regards to instrument types, system importance, user types and system characteristics.
- 23 Furthermore, we expect the volume of abusive or improper trades that seek shelter from ATSS implementing monitoring standards and move to voice broking or offshore to be very small. Even if such an effect were material, we do not think we would be obliged to count it as a real cost under our CBA framework.
- 24 We have not been able to quantify the cost, if any, arising from the potential for a diminished variety of services on offer. To the extent that the costs would otherwise be counted under other cost categories (for example, lesser number of trades), we believe they will be of no more than minimal significance.

Options

- 25 Paragraph 17 lists the assumptions underlying the cost-benefit analysis of our proposals. This section exposes cost-benefit considerations in respect of the policy options underlying these assumptions. These were:
- whether the standards should be imposed through rules, guidance and evidential provisions, or through requirements on firms' permission;
 - whether our proposals should cover service companies that operate ATs; and
 - whether our proposals should cover commodity derivatives as well as ISD instruments.
- 26 We have addressed the question whether our CBA is affected by which of the choices for implementation of Standards 2–5 and conduct of business issue (c) (the rules approach or the requirements approach) is ultimately adopted. We do not believe there is a need to adjust our CBA for these approaches, believing that compliance costs, our costs, and other costs, will be broadly equivalent. Compliance costs will be the same whether the standards are expressed as rules or requirements. Our costs will also be similar. On the rules approach, there will probably be a significant number of requests for individual guidance as firms seek guidance on the precise content of the standards with respect to their particular kind of business. This will involve us in some policy work in deciding what that content should be. On the requirements approach, the same work will need to be done, but at an earlier stage, i.e. in drawing up requirements on permission. So, the total cost will be similar (timing differences will not be material in this context).
- 27 We believe that the service companies and commodities firms that operate ATs will be affected by similar costs as apply to other categories of firms. We believe that service companies and commodities firms operating ATs present similar risks to our objectives as presented by other ATS operators, and that the benefits of imposing ATS regulation on them will also be similar. Under our approach to service companies outlined in Chapter 3 of this paper, we intend to apply COB and other Handbook provisions to these firms only to the extent necessary to implement the standards, and no further. We propose a similar approach to energy market participants and oil market participants. The cost of complying with the standards for them will, we believe, be similar as for other firms. For other commodities firms (such as ISD firms) we do not believe the costs of complying with the new regime will be materially different.

Conclusion

- 28 We believe that the costs of implementing the standards, while real, are outweighed by the benefits to be gained. We have not sought to quantify the benefits, believing that this is not reasonably possible, in any case there are some unquantifiable costs on the other side of the ledger. Nevertheless, we believe that on balance the standards will bring benefits to consumers, market participants and ultimately ATs themselves, that will outweigh the implementation and other costs set out above.

Compatibility with our general duties

Introduction

- 1 In proposing to make rules and general guidance on rules, we are required by sections 155 and 157 of FSMA to give an explanation of our reasons for believing that making the proposed rules or guidance is compatible with our general duties under section 2 of FSMA. This chapter is the explanation required by those provisions of FSMA.
- 2 Our general duties apply when we are exercising our general functions, which include making rules and issuing general guidance. They are the duties:
 - to act, so far as is reasonably possible, in a way which:
 - a) is compatible with the regulatory objectives as set out in section 2; and
 - b) which we consider the most appropriate for the purpose of meeting those objectives; and
 - to have regard to the principles of good regulation as set out in section 2.
- 3 The regulatory objectives, and the principles of good regulation, are discussed in detail below.

Compatibility with the regulatory objectives

- 4 The draft Handbook text we are proposing has relevance to each of the statutory objectives set out in the FSMA. Those objectives are as follows:
 - **market confidence**, i.e. maintaining confidence in the financial system;
 - **public awareness**, i.e. promoting public understanding of the financial system;
 - **consumer protection**, i.e. securing the appropriate degree of protection for consumers; and

- **reduction of financial crime**, i.e. reducing the extent to which it is possible for a business carried on by a regulated person, or in contravention of the general prohibition, to be used for a purpose connected with financial crime.

5 Which objectives are relevant to which standards is set out in Table B.1.

Table B.1. Statutory objective relevant to each standard or issue

Standard/issue	Market confidence	Public awareness	Consumer Protection	Reduction of financial crime
1. Notification	•		•	
2. Fair and orderly trading	•		•	•
3. Publication of trading information	•	•	•	•
4. Monitoring	•		•	•
5. Arrangements with regulators	•		•	•
6. Systems	•		•	
7. Clearing and settlement	•		•	
Conduct of business issues (a) & (b) (Clarity of relationship and system information)			•	
Conduct of business issue (c) (Publicly available information)	•	•	•	

6 Taking each objective in turn, we think implementing the Standards (or maintaining those parts of the Handbook that already implement the Standards, where applicable) will contribute to the objective as set out below.

Market confidence

7 All standards, and conduct of business issue (c), are relevant to this objective. We think market confidence will be enhanced by implementing the Standards for the following reasons:

- Standard 1 (notification) will support this objective by ensuring that we are aware of those ATs that are operated by regulated firms, and is in a position to ensure that adequate arrangements are in place for their supervision.
- Standard 2 (fair and orderly trading) will play an important role in supporting this objective by ensuring that ATs have adequate rules and

arrangements for fair and orderly trading will ensure the proper functioning of the marketplaces represented by those ATs and increase market confidence in the broader markets for instruments traded on ATs.

- Standard 3 (publication of trading information) will increase market confidence by making the comparison of prices across trading venues easier, by stimulating the market for the resale of trading information, and by enabling end users to ensure that intermediaries are giving value for money.
- Standard 4 (monitoring) will enhance market confidence by ensuring that ATs are in a position to pick up potentially abusive or improper trading strategies.
- Standard 5 (arrangements with regulators) similarly enhance market confidence by ensuring that ATs are in a position to deal effectively with us (and investment exchanges, where relevant) where potentially abusive or improper trading strategies are identified.
- Standard 6 (systems) needs no implementation, but existing Handbook material is directed at ensuring that ATs are operated under robust systems and controls.
- Standard 7 (clearing and settlement) is designed to increase the clarity and effectiveness of clearing and settlement arrangements, thereby enhancing market confidence.
- Conduct of business issue (c) (publicly available information) is designed to ensure that investors have adequate information, indirectly helping to maintain market confidence.

Public awareness

8 The standards and conduct of business issue relevant to this objective are Standards 3 and conduct of business issue (c):

- Standard 3 (publication of trading information) is relevant. Requiring ATs operators to make trading information publicly available (albeit at a reasonable commercial rate) will inevitably raise the profile of the ATs sector among investment professionals and consumers of financial services more generally.
- Conduct of business issue (c) (publicly available information) may also increase the volume of information about ATs-traded securities that is made available, with the result that public awareness of this sector of the financial system, and of the securities themselves, is increased.

Consumer protection

- 9 We think all standards and conduct of business issues are relevant to this objective, in the following ways:
- Standard 1 (notification) will support this objective by ensuring that we are aware of those ATs that are operated by regulated firms, and are in a position to ensure that adequate arrangements are in place for their supervision.
 - Standard 2 (fair and orderly trading) will help ensure that direct users and end users are treated fairly by system operators and that losses suffered as a result of disorderly trading are minimised.
 - Standard 3 (publication of trading information) will enable end users to ensure that intermediaries and market infrastructure providers such as ATs and exchanges are giving value for money, by enabling them to compare execution prices and spreads across trading platforms.
 - Standard 4 (monitoring) will enhance consumer protection by ensuring that ATs are in a position to pick up potentially abusive or improper trading strategies, which might be to the detriment of particular consumers.
 - Standard 5 (arrangements with regulators) will similarly enhance consumer protection by ensuring that ATs are in a position to deal effectively with us (and investment exchanges, where relevant) where potentially abusive or improper trading strategies are identified.
 - Standard 6 (systems) needs no implementation, but existing Handbook material is directed at ensuring that ATs are operated under robust systems and controls, thus affording protection to direct users of ATs' services as well as to end users.
 - Standard 7 (clearing and settlement) is designed to increase the clarity and effectiveness of clearing and settlement arrangements, thereby enhancing consumer protection.
 - Conduct of business issues (a) and (b) (Clarity of relationship and system information) are designed to ensure that consumers have adequate information, in a permanent form, about a system and its operator.
 - Conduct of business issue (c) (publicly available information) is designed to ensure that investors have adequate information to form an investment judgment, thereby reducing the possibility of mis-buying of securities.
- 10 Section 5 of FSMA provides that, in determining what is the appropriate degree of protection for consumers, we should have regard to:

The differing degrees of risk involved in different kinds of investment or other transaction

- 11 We have taken care to retain the flexibility according to investment type that CESR has built into the Standards.

The differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity

- 12 We propose implementing some of the Standards by way of COB rule for private and intermediate customers, and by way of guidance for market counterparties, thereby reflecting the different degrees of expertise and need for protection of these different kinds of consumers.

The needs that consumers may have for advice and accurate information

- 13 In particular, conduct of business issues (a), (b) and (c) are addressed with this factor in mind.

The general principle that consumers should take responsibility for their decisions.

- 14 We have taken this factor into account by requiring the provision of certain kinds of information to consumers, while leaving consumers free to make investment decisions, and choices of execution venue, based on that information.

Financial crime

- 15 The standards relevant to this objective are Standards 2, 3, 4 and 5. They are relevant to this objective in the following ways:

- Standard 2 (fair and orderly trading) will help ensure that direct users and end users are treated fairly by system operators and that losses suffered as a result of disorderly trading are minimised. The possibility of an ATS being used to further financial crime is lowered where disorderly trading is minimised.
- Standard 3 (publication of trading information) will bring to light trades done on ATSS in a similar manner as they are brought to light when done on exchange. As such, the risk of potentially abusive trading, or trading otherwise conducing to financial crime, being conducted will be lowered.
- Standard 4 (monitoring) will enhance consumer protection by ensuring that ATSS are in a position to pick up potentially abusive or improper trading strategies. Such trading strategies will sometimes be the concomitants of financial crime such as money laundering or fraud, and may sometimes constitute financial crime in their own right.
- Standard 5 (arrangements with regulators) will similarly reduce financial crime by ensuring that ATSS are in a position to deal effectively with regulators where potentially improper or abusive trading strategies are identified.

Principles of good regulation

- 16 We have had regard to the principles of good regulation set out in section 2 of FSMA in the following ways:

The need to use our resources in the most efficient and economic way

- 17 We have decided not to introduce a new type of regulated activity (as a sub-category of arranging deals in investments) for operators of ATs, partly¹ on the grounds of administrative cost to us. This would be mainly incurred in amending existing permissions for firms not operating ATs, so as to remove operating an AT from the scope of the firm's permission.

The responsibilities of those who manage the affairs of authorised persons

- 18 We are proposing to implement the CESR standards for ATs in a way that is consistent with the light touch regime for inter-professional business, where possible, while also placing reliance on existing standards for senior management arrangements, where appropriate. We believe our rules are flexible enough not to inappropriately shift management responsibility to us.

Being proportionate in imposing burdens or restrictions

- 19 Another of the principles of good regulation is the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction.
- 20 We are proposing to implement the Standards in a way that is light touch while being consistent with the Standards themselves, so as to minimise the danger of over-regulation in the absence of evidence of grave market failure. For example, we propose to rely on existing Handbook material where it is reasonably fit for purpose.
- 21 We have also stated that overall we believe the benefits of implementing the Standards outweigh the costs.

The desirability of facilitating innovation in connection with regulated activities

- 22 The standards are designed to be technologically neutral. Any multilateral non-discretionary execution platform, whether automated or not, will be covered by the Standards. However, in practice, it is likely that at least some voice brokers will not be caught by the Standards as they will not be conducting business in a non-discretionary way.

1 We also think such a move would prejudge the debate in the revised ISD context.

- 23 There is a potential concern that imposing the Standards on ATs would lead to business and order flow migrating to less developed execution facilities. We do not believe that this concern will be borne out to any significant extent in practice. The business case made by ATs will ordinarily be enhanced, not diminished, where an ATs complies with the Standards. We expect ATs to retain their competitive advantages over voice brokers in terms of cost of execution, depth of interest and global reach, notwithstanding imposition of the Standards.

The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom

- 24 As stated, we are proposing to implement the Standards in a way that is light touch while being consistent with the Standards themselves. This has been done to minimise the danger of driving this nascent business sector to non-EEA jurisdictions while maintaining the UK's status as a jurisdiction with good standards of regulation and our status as a reliable member of CESR, committed to implementing standards where consistent with our statutory duties. We would also expect those CESR regulators with an ATs sector to implement the Standards.
- 25 We hope that the fact of being regulated as an ATs in the UK will come to be seen by firms themselves as a competitive advantage over ATs based in other jurisdictions, both within and without the EEA.

The need to minimise any adverse effects on competition

- 26 If we were to increase some of the obligations on ATs, particularly in the public transparency and monitoring arena, ATs would possibly find it more difficult than previously to compete with those voice brokers who remain outside the scope of the regime. ATs would possibly also find it harder to compete with exchanges for business, as this point of differentiation is no longer available, or available to the same extent, as previously.
- 27 We have been conscious of these possible adverse effects on the competitive position of ATs and have sought to minimise them so far as possible (for example, by relying on existing Handbook provisions where fit for purpose, and by keeping the public transparency requirements flexible and high-level). We have also applied the implementation to a category of firm – service companies – which operate ATs. Not doing so would leave some ATs at a disadvantage, compared with others.

The desirability of facilitating competition between those who are subject to any form of regulation by the Authority.

- 28 We are concerned with ‘effective competition’ rather than mere competition per se. We consider effective competition to be circumstances in which consumers are provided with adequate information, can make informed decisions based on product comparisons, and can therefore drive poor value or unsuitable products out of the market.
- 29 We believe that the Standards as implemented will enable consumers, both as end users of ATs and other execution venues and as direct users, to make better informed and more effective choices both between execution venues and between the financial intermediaries who are the direct users of execution venues. We believe that by positioning the regulation of ATs in terms of complexity and burdens imposed somewhere between the level of regulation of ordinary securities firms and that borne by recognised exchanges, we are recognising that ATs, in many ways, operate as a half-way house between these business models. As such, we believe we are indirectly facilitating more effective competition between ATs and exchanges, and between voice brokers and ATs, as explained above.

Most appropriate for meeting regulatory objectives

- 30 By putting into practice the proposals contained in this Consultation Paper we would, we believe, be acting in the most appropriate way for the purpose of meeting our regulatory objectives with regards to ATs and the risks they pose.
- 31 In determining the appropriate method for implementing each standard, and indeed whether each standard required implementation, we have taken care to ensure that our proposed response:
- is proportionate;
 - takes account of the differing risks posed to differing classes of consumers and by differing systems and instruments; and
 - minimises the costs and maximises the benefits of implementing the standard. See Chapter 5 and Annex A for more details of our CBA.
- 32 In each case, we have considered carefully whether any action at all was justified in the light of the standard and our existing Handbook provisions. In the case of Standard 6, we are proposing no change. For all other standards, we think existing Handbook provisions do not deal with the issue addressed with enough specificity.

CESR standards and selected commentary

Standard 1: Notifications

Investments firms should be required by their home state regulatory authority to notify the establishment of a qualifying system.¹ They should also notify the home state regulatory authority (and, where different, the home state regulatory body in that member state responsible for the oversight of markets) of its key features and significant changes to its operation.

At initial notification, home state regulators should require information from the operator of a qualifying system relating to the following issues (it is accepted that in some cases there might be nil returns on one or more topics):

- the trading process, including the types of order/quote information to be input into the system and the basis upon which buying and selling interests are brought together;
- the arrangements for making pre- and post-trade information available to users and to the general public;
- the system design, the arrangements for the management of the system, and any outsourcing arrangements;
- the types and numbers of users and the access arrangements for users;
- the instruments traded;
- the nature of any arrangements with different classes of user, e.g. contracted liquidity providers;
- the existence of any incentive arrangements to boost liquidity/turnover;
- the arrangements for the clearing and settlement of transactions;

¹ The term used in the CESR Standards for ATS.

- the arrangements for ensuring compliance with any regulatory requirements imposed by home state regulators to implement these Standards (once the precise application has been determined by the relevant regulatory authority).

In addition, subsequent to initial notification, home state regulators may require information:

- at appropriate intervals, on the volumes and values traded, the numbers of users, and other pertinent statistics (depending, for instance, on the nature of the instruments traded, scale of operation etc);
- with immediate effect, on any material changes to the operator(s) of the qualifying system, the trading process, the instruments traded, the categories of system user, the clearing and settlement arrangements, and the system design or system management arrangements.

Standard 2: Fair and orderly trading

Investment firms operating a qualifying system should establish trading arrangements that result in fair and orderly trading.

In respect of fair and orderly trading, the system should be designed and operated to provide for efficient pricing and the equitable treatment of users. While the trading arrangements will vary depending on the service being offered to users (e.g. price/time order matching, quote-driven systems, reference-price crossing), the operator should be able to demonstrate that the trading methodology is fair and orderly. In particular, the operator should be able to demonstrate that the trading methodology enables the users to obtain the best price available on the system, at the time and for their size of order. Users should also be able to view sufficient information on orders and completed transactions. The extent of this requirement will depend on the characteristics of the system, e.g. information on orders may not be appropriate for pure price taking systems.

In considering the way in which regulators should implement this Standard, CESR recognises that differentiation should be made between professional and retail users.

Standard 3: Publication of trading information

An investment firm operating a qualifying system providing trading in an instrument traded on a regulated market² must make publicly available, on a

² i.e., a regulated market within the meaning of the ISD

reasonable commercial basis, information about quotes and/or orders that the qualifying system displays or advertises to the system users. Similarly, operators must make publicly available, on a reasonable commercial basis, information relating to completed transactions that the system provides to users.

[I]nvestment firms operating qualifying systems which provide trading in instruments traded on a “regulated market” must be ready to make relevant trading data available on a timely basis. They might fulfil this obligation, which they may be able to do on a reasonable commercial basis, by posting data on a web-site, making it available to an information vendor or supplying it to any consolidated quotation system. CESR recognises that home state regulators may authorise firms to delay such publication in respect of orders that are large compared with normal market size for the financial instruments concerned, where similar arrangements are in existence on the underlying regulated market.

Any requirements for pre- and post-trade information, to be made available as stipulated above, should be no more onerous than those imposed on the regulated market in that instrument by the home state of the investment firm operating the qualifying system, or, where there is no relevant regulated market in that jurisdiction, by the national laws of the Member State having responsibility for the relevant regulated market.

In other words, where the competent authorities have implemented pre- and post- trade transparency under the current ISD,³ these requirements will form the overall benchmark for the qualifying system. However, regulators recognise that they will need to adapt such benchmarks to particular market microstructures – for instance, market maker transparency requirements may not be adequate for central order book qualifying systems. Similarly, pre-trade information is unlikely to be appropriate for crossing networks and will be applied to other qualifying systems in a manner that reflects their business model. Overall benchmarking of transparency Standards will allow qualifying systems to employ the same flexibility as regulated markets, e.g., with regards to treatment of large orders.

Standard 4: Monitoring

Investment firms operating a qualifying system should monitor user compliance with the contractual rules of the system.

In any case, operators should act in the event of misuse and, for this purpose, should ensure that their contracts with users enable them to do so by, for example, terminating access.

3 i.e., the ISD as in force at the time of promulgation of these Standards. [CESR footnote]

... If the system design restricts the scope for user misuse, there might be less need for direct monitoring. Monitoring will be particularly important if non-professional users have access to the system and/or if the system plays an important role in the price formation process for a particular investment. In such cases, the qualifying system (or its operator) should have the ability to monitor user compliance closely to ensure that the scope for misuse is limited and, if it does occur, is identified quickly.

Standard 5: Arrangements with regulators facilitating market integrity and investor protection

Investment firms operating a qualifying system should, where their home state regulatory authority requires it for the purposes of investor protection and market integrity, establish arrangements with that authority to facilitate satisfactory monitoring of the markets in the instruments traded and the detection of market abuse.

In instances where an investment firm operates a qualifying system providing trading in instruments traded on other systems, any unfair practices and market abuse will adversely affect not only users of the qualifying system, but also the wider market in these instruments. In these cases, the operator needs to be able to supply relevant information – e.g. trading data (in addition to the one already required under Article 20(1) of the ISD) – to its home state regulatory authority, which in turn would be able to use this information in its co-operation with any relevant regulatory authorities in its member state and to provide information to the host country regulatory authority in accordance with the information sharing provisions of the ISD or other relevant law.

Where the instruments are admitted to trading on a regulated market, the arrangements to be established by the investment firm operating a qualifying system could be elaborated under three different routes. Relevant monitoring could be done either (i) by the operator itself, (ii) in co-operation with the exchange operating the underlying regulated market and acting as market authority, or (iii) in co-operation with its home state regulator. The effective level of monitoring should be equal (in markets with similar characteristics) under the three options.

Standard 6: Systems

Investment firms operating an ATS should be able to demonstrate to the relevant home state regulatory authorities that the system is capable of delivering the proposed service, that there are satisfactory arrangements for

the management of the technical operation of the system and that there are satisfactory contingency arrangements in the event of system disruption.

It is important to system users that they can rely on the trading systems they use to perform efficiently and robustly. It is incumbent on any investment firm to be able to demonstrate to its regulator that its systems – whether operated by the firm’s staff or out-sourced – are capable of delivering the functionality advertised and that it has arrangements in place to manage operational risk. Regulators of investment firms operating qualifying systems will pay particular attention both to security and system processes, in particular a system’s ability to process orders on a timely and equitable basis and to handle substantial variations in volumes.

A firm operating a qualifying system should have satisfactory arrangements for dealing with any disruption to its system. At the least, there should be arrangements for monitoring the system to ensure that it is operating to its specified Standards; and there should be adequate provision for the recovery of data in the event of a systems failure. Whether or not regulators consider it appropriate to require the operator of a system to have a standby trading facility may depend on the significance of the system to its users or to the markets in which it provides a trading service.

It is particularly important to users of the system that they are properly protected against unauthorised access to the system, which might endanger the confidentiality and integrity of the data. System operators should therefore ensure that access arrangements are properly controlled, whether directly by themselves or by third parties providing links to the system.

This above Standard is particularly important for qualifying systems which are integral to the broader market in a particular instrument in one or more Member States. Disruption to such an integral system could lead to financial losses for users, as well as the wider public, and a loss of confidence in the wider financial system.

The sophistication of the users of the system may also play a role when determining the exact requirements placed on a qualifying system under this Standard.

Standard 7: Clearing and settlement

Investment firms operating qualifying systems should ensure that there is clarity of obligations and responsibilities for the clearing (where applicable) and settlement of transactions.

Investment firms operating a qualifying system should ensure that there is clarity as to the respective responsibilities of the operator and the user with

regard to effective arrangements for the performance of transactions. However, where the system has retail users, the operator should be able to satisfy its regulator that arrangements are in place – whether or not provided by itself – to ensure efficient clearing (where applicable) and settlement.

Conduct of business issue (a): Clarity of relationship

Investment firms operating a qualifying system should make clear the nature of the relationship between operator and user.

The firm operating the qualifying system must have an agreement with its users which clearly sets out the nature of the relationship between the user and the operator of the system. This obligation does not affect in any way the substance of the obligations imposed on the investment firm by conduct of business rules relating to treatment of users.

Conduct of business issue (b): System information

Investment firms operating a qualifying system should supply sufficient information about the system to enable a user to use the system efficiently and to understand any risks arising in using the system.

Investment firms operating a qualifying system must supply adequate information to users on its main characteristics. This information should be sufficient to allow the user both to be able to use the system efficiently and to understand any risks arising in using the system. How much information is required will depend on the sophistication of the users.

The information should cover:

- the operation of the system, including the order handling and order execution processes;
- the status of other users of the system, e.g. professional/ non-professional, domestic/foreign;
- the procedures (if any) to be adopted in the case of trading ‘errors’ or disputes;
- whether the user has any duty – under national regulation – to have arrangements for reporting to a regulatory authority transactions executed on the system;
- the circumstances in which the operator of the qualifying system could terminate a user’s access;

- trading procedures (if any) that may be adopted in the event of system malfunction;
- where appropriate arrangements for the clearing and settlement of the trades.

Conduct of business issue (c): Publicly available information

Investment firms operating a qualifying system should provide, or be satisfied that there is access to, sufficient publicly available information to enable users to form an investment judgement, taking into account both the nature of the users and the type of instruments traded.

System users should be able to obtain access to available and/or accessible information in respect of prospective transactions in instruments traded on the system, as for example when a prospectus or other disclosure documents is required under law in respect of a security traded on the system. The need for this information, and its extent, will depend on the experience of the users of the system and on the nature of the product. ...

For securities, system users also need information about the issuer to enable them to make an investment judgement on the instruments traded.⁴ The system operator should indicate to users where publicly accessible information may be obtained. This obligation could be considered satisfied where the securities have been subject to a public offering for which a prospectus has been made available or have been admitted to official listing on an EEA stock exchange. In the case of unlisted securities, the operator should indicate that the securities are unlisted, likely to be subject to lesser disclosure requirements and fall outside the scope of market abuse legislation. Whether these requirements are necessary in all circumstances will depend on the type of user, the type of instrument traded and the conventions in the wider market in that instrument. Where this information is not already publicly accessible, the operator might have to take responsibility for providing appropriate information to users.

... Where sufficient information is already available, CESR would not expect qualifying systems to be required to duplicate it.

⁴ e.g. basic information on the issuer, recent company news or disclosable events that may affect the value of a company or its securities, or in the case of derivatives, current trading information on the underlying assets. [CESR footnote]

Glossary

ATS	Alternative Trading System, as defined in the proposed Handbook definition
ATS operator	The operator of an ATS, as defined in the proposed Handbook definition
AUTH	The <i>Authorisation manual</i> , a module of the FSA Handbook
CBA	cost-benefit analysis, as required by s. 155 of FSMA
CESR	Committee of European Securities Regulators (website at http://www.europefesco.org)
CESR Standards	<i>Standards for Alternative Trading Systems</i> , CESR, July 2002, Doc. no. CESR/02-086b, available at http://www.europefesco.org/DOCUMENTS/STANDARDS/02-086b.pdf
CFTC	Commodity Futures Trading Commission
COB	<i>Conduct of Business sourcebook</i> , a module of the FSA Handbook
COND	<i>Threshold Conditions</i> , a module of the FSA Handbook
EC	European Commission
ECD	E-Commerce Directive, No. 2000/31/EC
EEA	European Economic Area, i.e. the EU plus Norway, Liechtenstein and Iceland
FESCO	Forum of European Securities Commissions, now replaced by CESR
FSMA	Financial Services and Markets Act 2000, as amended

Handbook	The FSA's Handbook of rules and guidance, available at www.fsa.gov.uk/handbook
ISD	Investment Services Directive, No. 1993/22/EC
ISD firm	investment firm within the meaning of the ISD
MAR	<i>Market Conduct sourcebook</i> , a module of the FSA Handbook
MIP	market infrastructure provider
OTC	over the counter, i.e. a transaction in securities or derivatives not conducted on an exchange
PRIN	<i>Principles for Businesses</i> , a module of the FSA Handbook
qualifying system	The term used in the CESR Standards for ATS
RAO	The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, Statutory Instrument No. 2001/544, as amended
REC	<i>Recognised Investment Exchanges and Recognised Clearing Houses sourcebook</i> , a module of the FSA Handbook
regulated market	regulated market within the meaning of the ISD
RIE	recognised investment exchange, as defined in FSMA
SEC	Securities and Exchange Commission
SYSC	<i>Senior Management Arrangements, Systems and Controls sourcebook</i> , a module of the FSA Handbook

List of questions

- Q 3.1 Do you agree with the proposed scope of the ATS regime?
- Q 3.2 In particular, do you agree with the proposed treatment of service companies and commodities firms?
- Q 3.3 Do you have any comment on the proposed definition of ATS and its accompanying guidance?
- Q 3.4 How, if at all, do you think ATSS should be distinguished from voice brokers?
- Q 3.5 Do you have any comment on the proposed timetable and its links with related policy processes?
- Q 4.1 Do you have any comments on our proposals on Standard 1?
- Q 4.2 Do you have any comments on our proposals on Standard 2?
- Q 4.3 Do you have any comments on our proposals on Standard 3?
- Q 4.4 Do you have any comments on our proposals on Standard 4?
- Q 4.5 Do you have any comments on our proposals on Standard 5?
- Q 4.6 Do you agree that the existing Handbook material adequately covers Standard 6?
- Q 4.7 Do you have any comments on our proposals on Standard 7?
- Q 4.8 Do you have any comments on our proposals on conduct of business issues (a) and (b)?
- Q 4.9 Do you have any comments on our proposals on conduct of business issue (c)?
- Q 5.1 Do you have any comment on the cost-benefit analysis contained in Annex A?
- Q 5.2 Do you have any comment on the compatibility statement contained in Annex B?

Annex F

Draft Handbook Text

In making the proposed text, the FSA would be exercising its powers under sections 51, 138, 149, 150(2), 156 and 157 of the Act.

In the proposed text, underlining indicates new text and striking through indicates deleted text.

Part 1 – Proposed amendments to the Reader’s Guide

Amend the Table headed “Contents of the Handbook” as indicated below:

	Sourcebook or manual	Reference Code
...
	Interim Prudential sourcebooks	IPRU
	for banks IPRU (BANK)	
	for building societies IPRU (BSOC)	
	for friendly societies IPRU (FSOC)	
	for insurers IPRU (INS)	
	for investment business IPRU (INV)	
Business Standards	Conduct of Business	COB
	Market Conduct:	MAR
	Code of market conduct	
	Price stabilising rules	
	Inter-Professional conduct	
	Endorsement of the Takeover Code	
	<u>Alternative Trading Systems</u>	
...

Part 2 – Proposed amendments to COB

Amend *COB* TP 3 Miscellaneous Transitional Provisions as indicated below:

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
...
<u>3</u>	<u>COB 4.2</u>	<u>R</u>	<p><u>ATS terms of business</u></p> <p><u>A service company, or a firm that is undertaking oil market activity or other energy market activity, that operates an ATS as at the day on which COB 4.2.17E comes into force is not required to provide terms of business to a customer who has commenced using the ATS before that day.</u></p>	<u>Indefinitely</u>	<u>Day on which COB 4.2.17E comes into force</u>
<u>4</u>	<u>COB 4.2</u>	<u>R</u>	<p><u>A firm is not, by reason of the insertion of COB 4.2.17E, required to amend, or to give notice of an amendment to, its terms of business to include provision about the additional matters in COB 4.2.17E in respect of a customer to whom it has provided terms of business before the day on which COB 4.2.17E comes into force.</u></p> <p>...</p>	<u>Indefinitely</u>	<p><u>Day on which COB 4.2.17E comes into force</u></p> <p>...</p>

Amend COB 1.2.1R as indicated:

- 1.2.1 R** COB applies to every *firm*, except that:
- (1) COB 9 (Client assets) does not apply to an *incoming EEA firm* with respect to its *passport activities*;
 - (2) for a *UCITS qualifier* and a *service company* (that does not operate an *ATS*), only COB 1.9 (Application to electronic commerce activity providers) and COB 3 (Financial promotion), and any provision of COB incorporated into COB 1.9 or COB 3 by reference, applies;
 - (2A) for a *service company* that operates an *ATS*, only COB 3 (Financial Promotion), any provision of COB incorporated into COB 3 by reference and, in relation to the operation of the *ATS*, COB 4.2 (Terms of business), applies.

...

After COB 1.6.11G insert:

- 1.6.12 R** Despite COB 1.6.6R to COB 1.6.11G, if a *firm* that is undertaking *oil market activity* or other *energy market activity* operates an *ATS*, COB 4.2 (Terms of business) applies in relation to the operation of the *ATS*.

Amend COB 4.2.11 as indicated:

- 4.2.11 E** (1) A *firm* should, in order to provide adequate detail, include in its *terms of business* provided to a *customer*:
- (a) a provision about each item set out in COB 4.2.15E ~~and~~ COB 4.2.16E and COB 4.2.17E, or in the case of a *service company*, or a *firm* that is undertaking *oil market activity* or other *energy market activity*, that operates an *ATS*, only provision about each item set out in COB 4.2.17E, except those the *customer* has requested not to be included; and
 - (b) any further or alternative provisions that the *customer* has asked for and on his own initiative agreed with the *firm*; to the extent that each such provision is relevant in the circumstance and that it is practicable to provide it.

...

After COB 4.2.16E insert:

4.2.17. E Table: Contents of terms of business provided to a customer of an *ATS*

Operating an *ATS*

Additional contents in respect of operating an *ATS*

When a *firm* operates an *ATS*, the *terms of business* provided to a *customer* should also contain information about the following:

- (1) how the system operates, including any order handling and order execution processes;
- (2) the status of other *users* of the system e.g. whether *market counterparties*, *intermediate customers* or *private customers* and whether domestic or foreign;
- (3) procedures (if any) to be adopted in the case of trading errors or disputes;
- (4) whether the *customer* has any duty under *UK* or other applicable laws to have arrangements for reporting to a regulatory authority transactions *executed* using the system;
- (5) the circumstances in which the *ATS operator* can terminate a *customer's* access to the system;
- (6) trading procedures (if any) that may be adopted in the event of system malfunction;
- (7) arrangements for the clearing and settlement of transactions, including the respective obligations and responsibilities (if any) of the *ATS operator* and the *customer* in relation to clearing and settlement;
- (8) if *investments* that are not *listed* are *traded on* the system, that *unlisted investments* are *traded on* the system, that those *investments* may be subject to lesser disclosure requirements and, if that is the case, that the *ATS operator* will advise the *customer* where publicly available information about the *investments* can be obtained;
- (9) if *investments* *traded on* the *ATS* fall outside the scope of the *market abuse regime*, that they are not covered by that regime and the effect of that regime not applying.

Part 3 – Proposed amendments to MAR

Insert in the table of contents of *MAR* after the items relating to “MAR 4 Endorsement of the Takeover Code”:

MAR 5 **Alternative Trading Systems**

<u>5.1</u>	<u>Application and Purpose</u>
<u>5.2</u>	<u>Guidance about what constitutes an ATS</u>
<u>5.3</u>	<u>Notification of establishment of an ATS</u>
<u>5.4</u>	<u>Rules applying to firms which operate an ATS</u>
<u>5.5</u>	<u>Parts of the Handbook applicable to the operation of an ATS</u>

Annex 1 MAR 5 1G

Amend *MAR* 3.1.1R as indicated

- 3.1.1 R** This chapter applies to every *firm* except:
- (1) a service company (unless the service company operates an ATS, in which case, MAR 3.4.10G and 3.4.10AG apply to the service company in relation to the operation of the ATS);
 - (2) *a non-directive friendly society;*
 - (3) *a non-directive insurer;*
 - (4) *a UCITS qualifier.*

After *MAR* 3.4.10G insert:

- 3.4.10A G.** A firm that is operating an ATS should take reasonable steps to ensure that the respective roles and responsibilities of the firm and the market counterparty in relation to use of the ATS are clear to the market counterparty. COB 4.2.17E sets out additional information about an ATS that an ATS operator should provide to its customers. An ATS operator may wish to consider whether some, or all, of this information should also be provided to market counterparties.

After chapter 4 of *MAR* insert the following chapter:

Chapter 5

Alternative Trading Systems

5.1 Application and purpose

Application

5.1.1 R This chapter applies to every *firm* that operates, or proposes to operate, an *ATS* except:

- (a) an *incoming ECA provider* acting as such;
- (b) an *incoming firm* with respect to its *passport activities* or *treaty activities* (but this chapter (other than *MAR* 5.3) does apply if it is acting as a *domestic ECA provider* or an *outgoing ECA provider*); and
- (c) an *overseas firm*, if the *ATS* is being operated from an *establishment* outside the *United Kingdom*.

Purpose

5.1.2 G The purpose of this chapter is to implement the Standards for Alternative Trading Systems published by the Committee of European Securities Regulators. The *FSA* considers that the implementation of these standards will protect the interests of consumers and promote market confidence.

Rights of action for damages

5.1.3 R A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 150 of the *Act* (and each of the *rules* in this chapter is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action).

5.2 Guidance about what constitutes an ATS

5.2.1 G *MAR* 5.2.2G to 5.2.8G set out *guidance* on the meaning of the expressions *ATS* and *bilateral system* (as defined in the *Glossary*).

“system”

5.2.2 G For the purposes of the definitions of an *ATS* and a *bilateral system*, a system is intended to include not only the electronic parts (if any) of a

system but also any rules, protocols, procedures and agreements that make up the system. It is also intended to cover the various parts of a system whether provided directly by the *ATS operator* or by another *person* under an arrangement with the *ATS operator*.

price taking systems

- 5.2.3 G** A system may be an *ATS* although it does not directly involve price formation. For example, a price taking system (that is, a system where the price is derived from a reference market) such as a crossing system may be an *ATS*.

“buying and selling interests”

- 5.2.4 G** The expression buying and selling interests is intended to include not only orders, but also quotes and indications of interest.

“brings together”

- 5.2.5 G** Buying and selling interests will be regarded as being brought together in the system if they are brought together under the system’s rules or by means of the system’s protocols or internal operating procedures. The concept of bringing together is intended to cover any process under which interests interact; this may be by automatic matching, by way of selection of interests by *users* themselves or otherwise. It is not necessary that the interests be displayed to *users*. The fact that after being matched the *users* must ratify a proposed transaction does not mean that the interests are not brought together in the system. However, systems such as order routing systems where interests are transmitted but do not interact are not intended to be covered by the definition of an *ATS*.

“non-discretionary rules”

- 5.2.6 G** The reference to non-discretionary rules in the definition of an *ATS* is intended to exclude systems where the operator exercises discretion as to how the interests interact. However, the reference is not intended to exclude a system just because the operator has discretion as to whether or not to enter an interest into the system. It is also not intended to exclude a system just because *users* have discretion about whether or not to take up or accept any expression of interest.

Bulletin boards etc

- 5.2.7 G** A bulletin board where users contact each other outside the system (i.e. not under the system’s rules and not by means of the system’s protocols or internal operating procedures) to negotiate the material terms of transaction will not be covered by the definition of an *ATS*.

Bilateral system/central counterparty

- 5.2.8 G** The definition of an *ATS* excludes *bilateral systems*. The definition of *bilateral system* is intended to capture a system that is like an *ATS* except that a single *person* or *persons* in the same *group* enter into every trade. It is not however intended to cover central counterparty systems, where in substance participants deal among themselves but where their deals are assumed by the central counterparty as buyer and seller. A central counterparty will have a flat book except if there is a default or mistake, while typically the counterparty in a *bilateral system* will take principal positions in *investments* on a continuous basis. The definition of *bilateral system* is slightly flexible in that occasional crossings of client orders will not of itself make the system an *ATS*.

5.3 Notification of establishment of an ATS

Application for permission

- 5.3.1 G.** A *person* who applies for a *Part IV permission* and proposes to operate an *ATS*, will be required to complete appropriate parts of the application pack relating to the operation of an *ATS* (see *AUTH* 3.9 (Procedures in relation to applications for Part IV permission)).

Variation of permission

- 5.3.2 G** If a *firm* that proposes to operate an *ATS* applies for variation of *Part IV permission* to carry on an additional regulated activity of *arranging*, the *FSA* considers that for the purposes of *SUP* 6.3 (Applications for variation of permission) the proposal will usually cause a significant change to the *firm's* business or risk profile. The *FSA* may therefore require the firm to complete the appropriate parts of the full application pack (see *AUTH* 3), as directed by the *FSA*.

By firm that already has relevant permission

- 5.3.3 G** If a *firm* that proposes to operate an *ATS* already has *permission* to carry on the regulated activity of *arranging*, the firm should give notice of the proposal to the *FSA* before it begins to operate the *ATS*, in accordance with *Principle* 11 (Relations with regulators). This is because the *FSA* considers that this is a business expansion that could have a significant impact on the *firm's* risk profile or resources (see *SUP* 15.3.8 G). When the *FSA* receives notice it may request further information from the *firm* such as the completion of a systems form.

Notification of significant changes to ATS

- 5.3.4 G** The *FSA* would also expect an *ATS operator* to give the *FSA* notice if there is any significant change to the operation of an *ATS* that it operates,

in accordance with *Principle 11* (Relations with regulators). Notice should be given as soon as reasonably practicable after the change.

5.4 Rules applying to firms which operate an ATS

Fair and orderly trading

5.4.1 R. An *ATS operator* must have arrangements in place designed to ensure that trading on the system is conducted in a fair and orderly manner.

- 5.4.2 E.**
- (1) An *ATS operator* should have appropriate arrangements in place designed to ensure:
 - (a) efficient pricing and the equitable treatment of *direct users*;
 - (b) a trading methodology that is fair and orderly and that enables *direct users* to obtain the best price available on the system at the time for their size and type of trade and taking into account *users'* willingness to trade with each other; and
 - (c) sufficient information about quotes, orders and completed transactions is made available to *direct users*.
 - (2) In (1), “appropriate” means appropriate having regard to the nature of the system, the nature of *investments traded* on the system, the experience of *users*, the extent to which the wider market for the particular *investment* involves *private customers*, the susceptibility of the *investment* traded to market abuse and the significance of the system in the overall market for the *investment*.
 - (3) Compliance with (1) may be relied on as tending to establish compliance with *MAR 5.4.1R*.
 - (4) Contravention of (1) may be relied on as tending to establish contravention of *MAR 5.4.1R*.

5.4.3 G. While *MAR 5.4.1R* applies in relation to all types of *direct users* of an *ATS*, the *FSA* recognises that a differentiated approach may be appropriate in relation to *direct users* who are *market counterparties* or *intermediate customers*. This is because these *users* will be better able to assess whether they are being treated fairly when using an *ATS*. If an *ATS* only has *market counterparties* or *intermediate customers* as *direct users*, this will be a relevant factor in assessing what type of arrangements are appropriate for the purposes of *MAR 5.4.1R*.

5.4.4 G *MAR 5.4.1R* is intended to apply in a differentiated way according to the nature of a system. For example, providing pre-trade information to *direct users* is unlikely to be appropriate for crossing networks.

Publication of trading information

- 5.4.5 R.** (1) This paragraph applies in relation to *investments traded on an ATS* only if those *investments* are also traded on a *UK RIE*, a *regulated market* or an *EEA commodities market*.
- (2) An *ATS operator* must have appropriate arrangements in place to make publicly available:
- (a) information about quotes or orders or both relating to *investments traded on the ATS* that the *ATS* displays or advertises to *direct users*; and
 - (b) information about completed transactions for *investments traded on the ATS* that the *ATS* makes available to *direct users*.
- (3) In (2), “appropriate” means appropriate having regard to the nature of the *ATS*, the nature and liquidity of *investments traded on the system*, market conditions and the scale of transactions, the need (where appropriate) to preserve anonymity of *users*, and the needs of different market participants for timely information.
- 5.4.6 G.** *MAR 5.4.5R* is intended to apply in a differentiated way according to particular circumstances relating to an *ATS*, such as the nature of a system. For example, publication of pre-trade information is unlikely to be appropriate for crossing networks.
- 5.4.7 G.** *MAR 5.4.5R* is not intended to require duplicative publication of information about quotes, orders or transactions. For example, if a transaction is trade reported to an exchange, and the price and volume is published by the exchange in a timely fashion (or is exempt from immediate publication as a block trade), the post-trade transparency obligations in *MAR 5.4.5R(2)(b)* would ordinarily be satisfied in relation to that trade.
- 5.4.8 G** *MAR 5.4.5R* is also not intended to result in a standard that is any more onerous in relation to an *investment* than the standard that applies under the *Act* or the relevant national law of another State (as the case may be) to the exchange operating the underlying market for that *investment*. For example, if the publication of large orders (e.g. block trading) may be delayed under the relevant law applying to an underlying market for an *investment*, then publication of that information may also be treated in the same way by an *ATS operator*.
- 5.4.9 G.** An *ATS operator* may make information publicly available under *MAR 5.4.5R* by a variety of means. For example, an *ATS operator* might satisfy the *rule* by posting data on a web-site, making it available to an information vendor or supplying it to a consolidated quotation system.

Monitoring compliance with contractual rules

- 5.4.10 R.** (1) An *ATS operator* must have arrangements in place that enable the *ATS operator* to:
- (a) monitor adequately compliance by a *direct user* with contractual rules; and
 - (b) take action against a *direct user* if there is non-compliance with contractual rules, for example, by terminating the *direct user's* access to its system.
- (2) In (1), “contractual rules” means terms of, or rules established under, any agreement between the *ATS operator* and a user that govern use of the *ATS*.
- (3) In (1), “adequate” means adequate having regard to the nature of the *ATS*, the nature of investments traded on the system, the experience of users, the extent to which the wider market for the particular investment involves private customers, the susceptibility of the investment traded to market abuse and the significance of the system in the overall market for the investment.

- 5.4.11 G.** What amounts to adequate monitoring for the purposes of *MAR 5.4.10R* (1)(a) will vary depending on the particular *ATS*. However, if *private customers* have access to the system or if the system plays an important role in the price formation process for a particular *investment*, closer monitoring would be expected. The monitoring should limit the scope for breach of contractual rules and identify any breach quickly if it does occur.

Arrangements to reduce market abuse

- 5.4.12 R.** An *ATS operator* must have arrangements in place to reduce the extent to which the system may be used for a purpose connected with market abuse.
- 5.4.13 E.** (1) An *ATS operator* should have appropriate arrangements in place to enable:
- (a) monitoring of the use made of a system so as to obtain information about possible patterns of normal, abnormal or improper use of that system;
 - (b) detection of possible instances of market abuse for example, by detecting suspicious patterns in the use of its system;
 - (c) communication of information about suspected market abuse as soon as reasonably practicable to the *FSA* and other appropriate organisations (such as the relevant operator of a *regulated market* for an *investment*).

- (2) In (1), "appropriate" means appropriate having regard to the nature of the *ATS*, the nature of *investments traded on the system*, the experience of *users*, the extent to which the wider market involves *private customers*, the susceptibility of the *investment* traded to market abuse and the significance of the system in the overall market for the *investment*.
- (3) Compliance with (1) may be relied on as tending to establish compliance with *MAR 5.4.12R*.
- (4) Contravention of (1) may be relied on as tending to establish contravention of *MAR 5.4.12R*.

5.4.14 G. The arrangements referred to in *MAR 5.4.12R* may involve relevant functions being performed by the *ATS operator* itself or by another *person* (such as the operator of a *regulated market* in the particular *investment*) under an arrangement with the *ATS operator*.

Access to sufficient publicly available information

- 5.4.15 R.**
- (1) An *ATS operator* must provide, or be reasonably satisfied that *users* have access to, sufficient publicly available information to enable *users* to make a reasonably informed judgement about the value of each *investment traded on the system* and the risks associated with that *investment*.
 - (2) In (1), "sufficient" means sufficient taking into account the nature and experience of *users* of the system and the type of *investment traded on the system*.

5.4.16 G. *MAR 5.4.15R* is not intended to require an *ATS operator* to duplicate the provision of information that is already provided or publicly available. *Users* will usually be taken to have access to sufficient publicly available information to make a reasonably informed judgement about an *investment* if the *investment* is admitted to trading on an *RIE*, a *regulated market* or an *EEA commodities market* (and is not suspended from trading on the *RIE* or market).

5.4.17 G. If sufficient publicly available information is not already available to *users* in relation to an *investment*, an *ATS operator* may have to take responsibility for providing appropriate information to *users* or require another *person* (such as an issuer) to make available appropriate information to *users*.

ALTERNATIVELY, IF IT WERE DECIDED TO IMPLEMENT SEVERAL OF THE STANDARDS BY IMPOSING REQUIREMENTS ON PERMISSION, MAR 5.4 AND ANNEX 1G WOULD READ AS FOLLOWS:

A5.4 Requirements imposed on Part IV permissions of ATS Operators

- A5.4.1 G** The *FSA* proposes to implement several of the Standards for Alternative Trading Systems published by the Committee of European Securities Regulators by imposing *requirements* on the *Part IV permission* of an *ATS operator*.
- A5.4.2 G** The *FSA* will impose the requirements on *Part IV permissions* in a way that has regard to the principle in the ATS standards that the standards should be implemented in a differentiated way taking into account the particular risk sought to be addressed and each *ATS's* circumstances.
- A5.4.3 G** If a *person* who proposes to operate an *ATS* applies for a *Part IV permission*, the *FSA* will be minded to impose the *requirements* under section 43 of the *Act*.
- A5.4.4 G** If a *firm* that proposes to operate an *ATS* applies for a variation of *Part IV permission* to carry on an additional regulated activity of *arranging*, the *FSA* will be minded to impose the requirements under section 44 or 45 of the *Act*.
- A5.4.5 G** In relation to firms that already operate an *ATS*, the *FSA* will be minded to impose the *requirements* using its powers under section 45 of the *Act*.
- A5.4.6 G** *MAR 5 Ann 1G* sets out a form of *requirements* that the *FSA* will be minded to impose on the *Part IV permission* of an *ATS operator*. The exact form may vary to take into account the matters set out in *MAR A5.4.2G*.

MAR 5 Annex 1 G

Form of requirements: Alternative Trading Systems

Fair and orderly trading

- A1** (1) The firm must, when operating an *ATS*, have appropriate arrangements in place designed to ensure:
- (a) efficient pricing and the equitable treatment of *direct users*;
 - (b) a trading methodology that is fair and orderly and that enables *direct users* to obtain the best price available on the system at

the time for their size and type of trade and taking into account *users*' willingness to trade with each other; and

- (c) sufficient information about quotes, orders and completed transactions is made available to *direct users*.
- (2) In (1), "appropriate" means appropriate having regard to the nature of the system, the nature of *investments traded on* the system, the experience of *users*, the extent to which the wider market in the particular *investment* involves *private customers*, the susceptibility of the *investment* traded to market abuse and the significance of the system in the overall market for the *investment*.

Publication of trading information

- A2**
- (1) This requirement only applies in relation to *investments traded on* an *ATS* if those *investments* are also traded on a *UK RIE*, a *regulated market* or an *EEA commodities market*.
 - (2) The firm must, when operating an *ATS*, have appropriate arrangements in place to make publicly available:
 - (a) information about quotes or orders or both relating to *investments traded on* the *ATS* that the *ATS* displays or advertises to *direct users*; and
 - (b) information about completed transactions for *investments traded on* the *ATS* that the *ATS* makes available to *direct users*.
 - (3) In (2), "appropriate" means appropriate having regard to the nature of the *ATS*, the nature and liquidity of *investments traded on* the system, market conditions and the scale of transactions, the need (where appropriate) to preserve anonymity of *users*, and the needs of different market participants for timely information.

Monitoring compliance with contractual rules

- A3**
- (1) The firm must, when operating an *ATS*, have arrangements in place that enable it to:
 - (a) monitor adequately compliance by a *direct user* with contractual rules; and
 - (b) take action against a *direct user* if there is non-compliance with contractual rules, for example, by terminating the *direct user's* access to its system.
 - (2) In (1), "contractual rules" means terms of, or rules established under, any contract between the *ATS operator* and a *user* that govern use of the *ATS*.

- (3) In (1), “adequate” means adequate having regard to the nature of the *ATS*, the nature of *investments traded on the system*, the experience of *users*, the extent to which the wider market in the particular *investment* involves *private customers*, the susceptibility of the *investment* traded to market abuse and the significance of the system in the overall market for the *investment*.

Arrangements to reduce market abuse etc

- A4**
- (1) The firm must, when operating an *ATS*, have appropriate arrangements in place to enable:
- (a) monitoring of the use made of a system so as to obtain information about possible patterns of normal, abnormal or improper use of that system;
 - (b) detection of possible instances of market abuse for example, by detecting suspicious patterns in the use of its system
 - (c) communication of information about suspected market abuse as soon as reasonably practicable to the *FSA* and other appropriate organisations (such as the relevant operator of a *regulated market* for an *investment*).
- (2) In (1), "appropriate" means appropriate having regard to the nature of the *ATS*, the nature of *investments traded on the system*, the experience of *users*, the extent to which the wider market for that particular *investment* involves *private customers*, the susceptibility of the *investment* traded to market abuse and the significance of the system in the overall market for the *investment*.

Access to sufficient publicly available information

- A5.**
- (1) The firm must, when operating an *ATS*, provide, or be reasonably satisfied that *users* have access to, sufficient publicly available information to enable *users* to make a reasonably informed judgment about the value of each *investment traded on the system* and the risks associated with that *investment*.
- (2) In (1), “sufficient” means sufficient taking into account the nature and experience of *users* of the system and the type of *investment traded on the system*.

END OF ALTERNATIVE TEXT OF MAR 5.4 AND ANNEX 1G

5.5 Parts of the Handbook applicable to the operation of an ATS

5.5.1 G The purpose of this section is to help prospective and actual *ATS operators* find their way around the *Handbook* by setting out which parts of it apply to them when operating an *ATS*.

5.5.2 G The application of the *Handbook* to the operation of *ATSs* is summarised in *MAR 5.5.3G*. *ATS operators* should read applicable parts of the *Handbook* to find out what the detailed regulatory requirements are for operating *ATSs*.

5.5.3 G

Table Handbook provisions applicable to ATSS

	Part of Handbook	Applicability to ATSS
High Level Standards	Principles for Businesses (<i>PRIN</i>)	This applies. However note that some Principles are (partially) disapplied for <i>clients</i> that are <i>market counterparties</i> as further detailed in <i>PRIN 3.4</i> .
	Senior management arrangements, Systems and Controls (<i>SYSC</i>)	This applies.
	Threshold Conditions (<i>COND</i>)	This applies.
	Statements of Principle and Code of Practice for Approved Persons (<i>APER</i>)	This applies to an <i>approved person</i> who performs a <i>controlled function</i> for an <i>ATS operator</i> .
	The Fit and Proper test for Approved Persons (<i>FIT</i>)	This applies.
	General provisions (<i>GEN</i>)	This applies.
Business standards	Interim Prudential sourcebooks (<i>IPRU</i>)	These apply.
	Conduct of Business sourcebook (<i>COB</i>)	In general, <i>COB</i> applies to <i>ATS operators</i> . <i>Service companies</i> that operate an <i>ATS</i> are subject to the provisions of <i>COB</i> mentioned in <i>COB 1.2.1R(2A)</i> . There are special terms of business set out in <i>COB 4.2.17E</i> for <i>ATS operators</i> that have <i>customers</i> (as opposed to those whose only <i>clients</i> are <i>market counterparties</i>). Most of <i>COB</i> will not apply to <i>ATS operators</i> if their business is wholly within the scope of <i>MAR 3</i> (Inter-professional conduct): see <i>COB 1.3.4R</i> .

	Part of Handbook	Applicability to ATSS
Business standards	Market Conduct sourcebook (MAR)	<p>MAR 1 (The Code of Market Conduct) applies. MAR 2 (Price Stabilising Rules) and MAR 4 (Endorsement of the Takeover Code) are likely to be of limited relevance to the business of an <i>ATS operator</i>.</p> <p>MAR 3 (Inter-Professional Conduct) will ordinarily be relevant to <i>ATSs</i> whose <i>clients</i> are <i>market counterparties</i>. MAR 3.4.10AG is particularly relevant to the information that these <i>ATS operators</i> should provide to their <i>clients</i>.</p> <p>Ordinarily, <i>service companies</i> are not covered by MAR 3. However, MAR 3.1.1R provides that MAR 3.4.10G and MAR 3.4.10AG apply to <i>service companies</i> that operate an <i>ATS</i>.</p> <p>MAR 5 (Alternative trading systems) is directly relevant to the operation of an <i>ATS</i>.</p>
	Training and Competence sourcebook (TC)	This applies.
	Money Laundering sourcebook (ML)	This applies.
Regulatory processes	Authorisation manual (AUTH)	This applies in relation to an application by a prospective <i>ATS operator</i> for <i>authorisation</i> . In particular, AUTH 3.24.1G provides that an applicant who wishes to operate an <i>ATS</i> that will have <i>private customers</i> as <i>users</i> , should provide sufficient information with its application to demonstrate that there are arrangements in place to ensure efficient clearing (where applicable) and settlement of transactions effected using the <i>ATS</i> .”
	Supervision manual (SUP)	This applies.
	Enforcement manual (ENF)	This applies.
	Decision making manual (DEC)	This applies.
Redress	Dispute resolution: Complaints sourcebook (DISP)	<p><i>ATS operators</i> are subject to the <i>compulsory jurisdiction</i> of the <i>Financial Ombudsman Service</i>.</p> <p>However, a <i>firm</i> which notifies the <i>FSA</i> under DISP 1.1.7R that it does not conduct business with <i>eligible complainants</i> (persons eligible to have a complaint considered under the <i>Financial Ombudsman Service</i>, as defined in DISP 2.4) will be exempt from the <i>rules</i> on complaint handling procedures for <i>firms</i> (DISP 1.2 to DISP 1.7) and from the <i>Financial Ombudsman Funding rules</i> (DISP 5.2 to DISP 5.8).</p>

	Part of Handbook	Applicability to ATSS
Redress	Compensation sourcebook (COMP)	COMP applies to all firms. However, ATS operators that do not conduct business that could give rise to a protected claim by an eligible claimant as defined and have no reasonable likelihood of doing so can gain exemption under COMP 13.3 from some compensation scheme levies.
	Complaints against the FSA (COAF)	This applies.
Specialist sourcebooks	Collective Investment Schemes Sourcebook (CIS)	ECO applies to an ATS operator that is an electronic commerce activity provider.
	Credit Unions (CRED)	REC does not apply to an ATS Operator.
	Electronic money (ELM)	
	E-commerce Directive (ECO)	The other specialist sourcebooks are likely to be of limited relevance to an ATS operator in respect of its operation of an ATS.
	Lloyd's (LLD)	
	Professional firms (PROF)	
Recognised Investment Exchanges and Recognised Clearing Houses (REC)		
Special guides	Service companies (SERV)	This applies to a service company that operates an ATS.
	Energy market participants (EMPS)	This applies to an energy market participant that operates an ATS.
	Oil market participants (OMPS)	This applies to an oil market participant that operates an ATS.
	Small friendly societies (FREN)	This does not apply.

Other proposed amendments to MAR

Amend Schedule 2 to MAR in the way indicated below:

~~There are no notification requirements in MAR.~~

<u>Handbook reference</u>	<u>Matter to be notified</u>	<u>Contents of notification</u>	<u>Trigger event</u>	<u>Time allowed</u>
<u>MAR 5.4.13E</u>	<u>Information about suspected market abuse</u>	<u>Information about suspected market abuse</u>	<u>Suspicion of market abuse</u>	<u>As soon as reasonably practicable</u>

Amend the Table in Schedule 4 to MAR by inserting at the end of the Table the following:

The following powers in the Act have been exercised by the FSA to make requirements in MAR:

Section 51 (Procedure)

Amend the Table at the end of Schedule 5 of *MAR* in the way indicated below:

Chapter / Appendix	Section / Annex	Paragraph	For Private Person?	Removed	For Other Person?
<i>MAR</i> 1					
(no rules)					
All rules in <i>MAR</i> 2 except <i>MAR</i> 2.3.3E and <i>MAR</i> 2.3.4E			Yes	Yes <i>MAR</i> 2.1.9R	No
<i>MAR</i> 2.3.3E, <i>MAR</i> 2.3.4E and <i>MAR</i> 2.3.5E			No		No
All rules in <i>MAR</i> 3 except <i>MAR</i> 3.5.7E			Yes	Yes <i>MAR</i> 3.1.5R	No
<i>MAR</i> 3.5.7E			No		No
<i>MAR</i> 4 (all rules)			Yes	No	No
<u><i>MAR</i> 5 (all rules)</u>			<u>Yes</u>	<u>Yes</u> <u><i>MAR</i> 5.1.3R</u>	<u>No</u>

Part 4 – Proposed amendments to AUTH

After *AUTH* 3.23G insert:

3.24 Specific obligations: applicants wishing to operate an ATS

3.24.1 G An applicant who wishes to operate an *ATS* that will have *private customers* as *users* should provide sufficient information with its application to demonstrate that there are arrangements in place to ensure efficient clearing (where applicable) and settlement of transactions effected using the *ATS*.

Part 5 – Proposed amendments to CRED

Amend the Table in Appendix 1 as indicated below:

	Sourcebook or manual	Reference code
...
Business Standards	5 interim Prudential sourcebooks Conduct of Business Market conduct, including: Code of Market Conduct Price stabilising rules Inter-professional conduct <u>Alternative Trading Systems</u> Training and Competence Money laundering	IPRU COB MAR TC ML
...

Part 6 – Proposed amendments to ELM

Amend the Table in *ELM* 1.5.2R in the way indicated below:

Block	Module	Application
...
Block 2 (Business Standards)	Market Conduct (<i>MAR</i>)	<i>MAR</i> 1 (The Code of Market Conduct) applies if an <i>ELMI</i> is seeking <i>guidance</i> as to whether or not <i>behaviour</i> amounts to <i>market abuse</i> . <i>MAR</i> 2 (Price Stabilising Rules), <i>MAR</i> 3 (Inter-Professional Conduct) and <i>MAR</i> 4 (Endorsement of the Takeover Code) do not apply to an <i>ELMI</i> when <i>issuing e-money</i> . <u><i>MAR</i> 5 (Alternative Trading Systems) will not apply to an <i>ELMI</i> as there are restrictions on the type of business activities that an <i>ELMI</i> may carry on.</u>
...

Part 7 – Proposed amendments to EMPS

Amend the Table in *EMPS* 1.2.3G in the way indicated below:

	Part of Handbook	Applicability to energy market participants
...
Business Standards	Conduct of Business sourcebook (COB)	Only some parts of <i>COB</i> apply to <i>energy market activity</i> : see <i>COB</i> 1.6.6R – <i>COB</i> 1.6.11G <u><i>COB</i> 1.6.12R</u> .
	Market Conduct sourcebook (<i>MAR</i>)	This applies; however <i>MAR</i> 2 (Price stabilising rules) is likely to be of only marginal relevance to the business of an <i>energy market participant</i> . <u><i>MAR</i> 5 (Alternative Trading Systems) applies to an <i>energy market participant</i> that operates an <i>ATS</i>.</u>
...

Part 8 – Proposed amendments to OMPS

Amend the Table in *OMPS* 1.2.2G in the way indicated:

	Part of Handbook	Applicability to oil market participants
...
Business Standards	Conduct of Business sourcebook (COB)	Only some parts of <i>COB</i> apply to <i>oil market activity</i> : see <i>COB</i> 1.6.6R – <i>COB</i> 1.6.11G <u><i>COB</i> 1.6.12R</u> .
	Market Conduct sourcebook (<i>MAR</i>)	This applies; however <i>MAR</i> 2 (Price stabilising rules) is likely to be of only marginal relevance to the business of an <i>oil market participant</i> . <u><i>MAR</i> 5 (Alternative Trading Systems) applies to an <i>oil market participant</i> that operates an <i>ATS</i>.</u>
...

Part 9 – Proposed amendments to SERV

Amend the Table in *SERV* 1.2.2G in the way indicated below:

	Part of Handbook	Applicability to service companies
... Business Standards	... Conduct of Business sourcebook (<i>COB</i>)	... <i>COB</i> 1.9 (Application to electronic commerce activity providers) and <i>COB</i> 3 (Financial promotion rules), and any provision of <i>COB</i> incorporated by reference in <i>COB</i> 1.9 or <i>COB</i> 3, apply. <u><i>COB</i> 4.2 applies to a service company in relation to the operation of an <i>ATS</i>.</u> The rest of <i>COB</i> does not apply: see <i>COB</i> 1.2.1R(2) and (2A). The permission given to service companies means that they must not approve financial promotions on behalf of another person or specified class of person, or deal with private customers. If the firm communicates financial promotions to market counterparties and intermediate customers only, <i>COB</i> 3 will have only very limited application (see <i>COB</i> 3.2.4R and <i>COB</i> 3.2.5R(1)).
	Market Conduct sourcebook (<i>MAR</i>)	<i>MAR</i> 1 (Code of market conduct), <i>MAR</i> 2 (Price stabilising rules) and <i>MAR</i> 4 (Endorsement of the takeover Code) apply to service companies. <i>MAR</i> 3 (Inter professional conduct) does not apply to service companies: see <i>MAR</i> 3.1.1R. <u>If a service company operates an <i>ATS</i>, then <i>MAR</i> 3.4.10G and 3.4.10AG apply to the service company in relation to the operation of the <i>ATS</i>. Otherwise <i>MAR</i> 3 (Inter professional conduct) does not apply to service companies: see <i>MAR</i> 3.1.1R.</u> <u><i>MAR</i> 5 (Alternative Trading Systems) applies to service companies that operate an <i>ATS</i>.</u>
...

Part 10 – Proposed amendments to the Glossary

Insert the following new definitions in the *Glossary* in the appropriate alphabetical position:

Alternative Trading System

a system that brings together multiple buying and selling interests in designated investments (other than life policies or stakeholder pension schemes or rights to or interests in life policies or stakeholder pension schemes), in the system and according to non-discretionary rules set by the system’s operator in a way that results in a contract, but does not include:

- (a) a system that is operated by an RIE or that is a regulated market or an EEA commodities market; or
- (b) a bilateral system.

ATS

Alternative Trading System

ATS operator

a firm which operates an ATS or which has accepted responsibility for an appointed representative who operates an ATS.

bilateral system

a system that brings together buying and selling interests in the way described in the definition of an Alternative Trading System, where a single person or persons in the same group enter into every transaction effected using the system, on their own account and not as a riskless principal interposed between a buyer and seller, or would enter into every trade in that way but for client orders that are crossed occasionally.

direct user

(in relation to an ATS) a person who directly uses the ATS but not including a client for whom that person is acting when using the ATS.

EEA commodities market

a market that facilitates trading in derivatives relating to commodities (other than a market operated by an RIE) that is operated by an entity that has its head office situated in the EEA and that is regulated as an exchange.

traded on

(in relation to an ATS) traded by means of the system including under the rules of, or by means of the protocols or operating procedures of, the system.

user

(in relation to an ATS) a direct user of the ATS and a client for whom the direct user is acting when using the ATS.

ISBN: 0117049409

The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7676 1000 Fax: +44 (0)20 7676 1099
Website: <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No. 1920623. Registered Office as above.