THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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FEEDBACK STATEMENT AND INVENTORY OF COMMENTS RECEIVED DURING THE PUBLIC CONSULTATION ON THE CONSULTATIVE PAPER

"PROPOSED STANDARDS FOR ALTERNATIVE TRADING SYSTEMS"

(FESCO/01-035b)

I Summary of key issues

FESCO/CESR has received 57 responses: 13 responses from exchanges/regulated markets and their association (FESE), 2 from the side of CSD's and clearing and settlement systems, 19 responses from investment firms and their associations, and 16 responses from banks and bankers associations.

A clear majority of respondents supported the CESR initiative and welcomed the opportunity to comment on the proposals. Having considered the respondents' comments carefully, CESR believes that it might be helpful to provide a response to the Consultation submissions.
The key issues raised in the responses are the following:

1. *The CESR/FESCO approach should be aligned with the Commission's approach to revising the ISD.*

CESR agrees that it is important not to expose regulated entities to unnecessary changes of the regulatory environment. The Commission's proposals for revising the ISD were issued during the consultation period of the CESR paper. In light of those proposals, CESR has decided to align its own approach as closely as possible with the current proposals for revision of the ISD. This has in practice been achieved through a narrowing of the definition of 'qualifying system'. The changes made should, in CESR's view, assist in ensuring that regulated entities are not subject to two fundamentally different changes to their regulatory regime. Rather the aim is to provide an appropriate interim regime prior to the ISD coming into force.

2. *The definition of a "qualifying system" is too broad and needs to be refined. The definition should be technologically neutral and enable commercial innovation and competition.*

CESR has taken respondents' views into account and has decided to narrow the definition of 'qualifying system' as well as provide more guidance on what type of systems would be included in such a definition. The revised definition aims to be more technologically neutral. CESR is also determined to ensure that its regulatory proposals and approach do not prevent commercial innovation and competition. It thinks that the proposed standards do allow for these principles to prevail. However, it is important to note that the proposed narrowing of the definition does not mean that CESR has dismissed the risks which may be arising from the operations of bilateral systems.

3. *The proposed differentiated implementation of the standards by national competent authorities is likely to result in a fragmented application of these standards and will not create a level playing field between ATSs and Regulated Markets, unless there is clearer guidance as to how authorities should implement the standards.*

CESR believes that it is important to allow for differentiation in the implementation of the standards to prevent a 'one size fits all' approach, which would risk damaging commercial innovation and competition. Through a clearer statement of where the regulatory responsibility lies and more guidance as to how standards should be implemented/differentiated, CESR aims to ensure that implementation is consistent between member states, as far as is possible when considering the different characteristics of the respective systems and national legal provisions.

4. *The differentiation in the application of the standards according to the different types of systems has to be clearer, allowing firms to understand how the standards would be applied in practice.*

CESR has provided more guidance under those standards where respondents asked for further guidance on implementation of the standards. Individual CESR members are happy to discuss the practical application further with the 'qualifying systems' for which they are the home country regulator.

5. *The user-facing standards should be a matter for conduct of business rules and should not be separate ATS standards.*

CESR acknowledges that there might have been some confusion created by the earlier inclusion of the user-facing standards. However, CESR still regards it as important to explain in the context of the standards paper the linkage to conduct of business rules, given the differing relationship of investment firms and their customers in the context of alternative trading systems. By restructuring the paper and explaining the background to the need for adaptation of the conduct of business rules, CESR makes clear that the aim is not to duplicate, replace, add to, or subtract from the conduct of business rules.

6. *Clearer differentiation between retail and wholesale users is needed. Some argued that inter-professional trading networks should be excluded from the application of the standards.*

CESR agrees that it is important to differentiate between retail and wholesale users of the system and has, where possible, made this differentiation even more explicit in the standards. CESR does not believe however that inter-professional trading networks should a priori be excluded from the application of the standards. Although professional investors are more able to protect themselves and therefore should be subject to 'light-touch' regulation, as far as the protection of market integrity is concerned, inter-professional trading networks are also important to regulatory authorities.

CESR believes that a pure differentiation on the basis of whom the direct users of the system are is potentially problematic, as in certain markets the underlying clients are clearly retail consumers – even if the trading is done between professional users.

7. *Recognition that ATSs can impact on market integrity where they provide trading facilities which fragment an existing market (with consequential loss of transparency).*

CESR is glad that most respondents agreed that in certain markets fragmentation of existing markets could lead to concerns about market integrity. CESR's aim in promulgating the standards is to provide an appropriate and proportionate regulatory regime, which takes into account the potential risks ATSs pose as well as acknowledges the benefits ATSs can bring to the efficient operation of markets.

8. *The standards should assist the process of mutual recognition of country of origin rules. The CESR/FESCO paper should state clearly that ATSs are to be regulated solely by the country of origin of the investment firm which operates the system.*

CESR has stated more clearly in the revised paper that the regulatory responsibility for ATSs (with respect to standards 1-7) lies solely with the country of origin of the investment firm which operates the system. The regulatory responsibility for the application of conduct of business rules is not affected by this paper, it continues to be governed by Article 11 of the ISD.

9. *The standards should not be finalised until a full cost benefit analysis has been done.*

CESR did ask for comment on its attempt to provide some cost-benefit background in its last consultation paper. Many respondents criticised the cost-benefits section, but unfortunately none provided any assistance as to how CESR might be able to improve its cost-benefit analysis. CESR recognises the need for a detailed cost benefit analysis as it will assist in the acceptance of the proposed new regulatory standards.

Subsequently, CESR attempted to set out in section II below, a qualitative framework within which it identifies the risks posed by ATSs, the benefits and the potential costs of the standards.

II Cost and Benefits Framework

1. CESR believes that any incremental regulation of investment firms with respect to the operation of qualifying systems should be proportionate to the risks involved and subject to consideration of the potential costs and benefits. In our previous consultation paper we invited input on the potential costs attached to the proposed standards. While some respondents stressed the importance of a cost-benefit analysis, we received no detailed indications from firms of the level of incremental costs they foresaw arising from implementation of the standards. This section therefore sets out a qualitative framework within which CESR considers it appropriate to identify the costs and benefits of the standards. There is no attempt, at this stage, to quantify those costs or benefits. While CESR believes this framework should provide a sound basis for a common approach to assessing the costs and benefits, it remains interested in receiving any comments and data, which could help it in further developing its cost-benefit work.

Risks

Market integrity

2. CESR's principal reason for proposing standards for Alternative Trading Systems is to address potential risks to market integrity and market efficiency. The development of new trading systems operating outside the established regulatory framework for market operators (i.e. exchanges /regulated markets) raises concerns in a number of areas. These include (depending on the systems and the investment product in which it provides a trading service):

   - **any adverse impact on the efficiency of the wider market in an investment arising from inadequate transparency in the ATS;**
   - **any adverse impact on the integrity of the wider market in an investment arising from inadequate arrangements to monitor for unfair or disorderly trading (or to co-ordinate effectively with other parties undertaking such monitoring in other parts of that market);**
   - **any potential adverse impact on price formation mechanism as a result of increased fragmentation (but not in all asset classes, as ATSs can also bring benefits to the market, for example by bringing together buyers and sellers on a small number of trading systems in the fixed income market);**
   - **any adverse impact on the integrity or efficiency of a market in which the ATS operator provides the sole or principal trading platform.**

3. As indicated above, CESR recognises that the extent of the risks outlined above will vary considerably, both between systems and between markets. This is why CESR has emphasised throughout the development of the standards proposed in this consultation paper that their implementation must be proportionate.

Distorted competition

4. While CESR's main concern with respect to ATSs is the potential risk to market integrity and market efficiency, it is also concerned that the regulatory costs of addressing these issues should, as far as possible, be allocated in a way that avoids any adverse effects on competition (whoever it is between), or stimulates regulatory arbitrage. The concept of the level playing field is, however, a complex one. This is because of the different business mix of different organisations, but also because, for investment firms, some aspects of market quality will also be partly supported through prudential and conduct of business rules. CESR believes that the most desirable overall outcome will be reached if it ensures that its approach to risk is both consistent and proportionate.

Development of the ATS market

5. The European marketplace has not developed in the way it was anticipated when CESR began to consider the need for a regulatory treatment of ATSs. While ATSs have made considerable impact in wholesale bond markets, their role in equity trading in Europe is not yet significant. However, CESR considers that the risks posed by the potential penetration of the retail market by ATSs still remain (market fragmentation, effects on price discovery and transparency).

Regulatory responsibilities

6. Investment firms operating qualifying systems often provide cross border services and may use the system in that respect. Confusion therefore increased as to which jurisdiction should be involved and which regulatory authorities would be competent for the regulation of such electronic platforms. CESR considers that the home country application of the market-facing standards should provide clarity as regards the respective responsibilities of host country and home country regulators. It should be noted, however, that the regulatory responsibility for the application of conduct of business rules is not affected by the standards and continues to be governed by Article 11 of the ISD.

Benefits

7. CESR believes that existing market integrity and conduct of business rules do not fully address the above risks posed by the specific nature of services provided via qualifying systems. Although CESR recognises that it is difficult to forecast the growth in the number of qualifying systems operating in the EU, or their significance in individual asset markets, it considers that new trading systems are already attaining significance in some markets, especially bond and certain derivative markets, and that there would be benefit, in terms both of market confidence and giving certainty to the industry, in regulators establishing a (proportionate) regulatory approach now rather than later.

Market integrity

8. The standards will generate the largest benefits where enhanced transparency improves market knowledge of current and recent pricing and so facilitates more efficient trading. CESR recognises that the appropriate transparency arrangements will differ according to the nature of the market and the characteristics of the trading system. However, publication of trading data by investment firms operating qualifying systems should improve the quality of the price formation process and ensure that the benefits of competing trading systems (which might otherwise be dissipated by market fragmentation) work to the benefit of the overall market.

9. CESR also believes that benefits will accrue to market confidence by ensuring that ATSs take reasonable measures to deter their use for unfair or abusive practices that may damage the market in any instrument in which they provide a trading service.

10. Finally, the standards should assist in leveling the playing field between qualifying systems and exchanges. The introduction of greater consistency in the regulation of similar functionality (i.e. that provided by an investment firm and an exchange in respect of the operation of electronic trading systems) should therefore assist the development of an environment in which competition is focussed on offering proper commercial benefit, rather than regulatory inequalities. At the same time, the commitment to deliver proportionate regulation, on a consistent and clear basis, should provide an environment in which service providers can compete and innovate with greater regulatory certainty. (However, it is difficult to predict whether improved investor confidence, and greater regulatory clarity for ATSs, will in itself have a material impact on the number of ATSs that markets are able to support).

Systemic risks

11. CESR considers that the regulation of ATSs provided by the standards would also reduce systemic risks, as firms should provide clarity as to the respective obligations and responsibilities of the operator and the user for the clearing and settlement of transactions. The standard on system security and capacity is another area, which should assist the reduction of systemic risk, particularly where an ATS is the only or most significant trading platform in a market.

Investor protection

12. Regulatory authorities responsible for investor protection and the operation of markets will be able to know which authorised investment firms in their jurisdiction operate qualifying systems and, will therefore address more efficiently any issues raised by qualifying systems. Indeed, investment firms operating ATSs should provide to their home country regulator information about the key features of the system, the service and trading that such system provides, and significant changes to its operation. Home country regulators

should also require information from the operator at initial registration of the qualifying system, such as the system participants and the type of financial instruments traded. The home country application of the standards should ensure an appropriate collection of information among member states and avoid any duplication of existing information requirements or potential confusion about respective regulatory responsibilities in the case of firms operating cross-border businesses.

13. The protection of the direct or indirect users of the system should also be reinforced, as the standards should ensure that ATSs operate services that provide efficient pricing and equitable treatment of users. Investment firms operating qualifying systems will have to establish trading arrangements that should demonstrate the fairness of the trading methodology as well as its efficiency. CESR believes that those requirements should improve the quality of the execution process, as it will assist the users in obtaining the best price available on the system. The differentiated application of those requirements depending on the professional or retail nature of the users should ensure coexistence of fair and orderly trading, with largely commercial disciplines operating between professional players.

Potential costs

14. CESR recognises that the implementation of the standards will involve costs to both operators of qualifying systems and regulators. While those costs are difficult to quantify, CESR considers that proportionate implementation of the standards will, in most cases, ensure that any incremental costs to firms are small. However, as noted above, CESR has not received detailed information on possible costs from respondents to its consultation. As a result these conclusions are necessarily high-level ones. We encourage market participants to share quantitative information of costs with us.

15. The differentiated application of the standards, which prevents a "one size fits all" approach, means also that it is difficult to estimate exact cost. However, for the firms themselves, the home country application of the standards will limit variation of the costs between the member states**.**

Identification of categories of costs

16. Costs relating to potential need of legal advice. Operators of qualifying systems will need to establish the extent to which these requirements may apply to some or all of their operations. This will likely require analysis of these standards, and any national implementing provisions, by qualified legal and compliance staff. This will incur a cost to systems operators, although this is not likely to be an unanticipated cost, as legal and compliance resources should already be in place.

17. Initial and on-going reporting costs. Investment firms operating a qualifying system will have to provide their regulator with some additional information.

These costs should generally be modest, as the standards will apply on a home country basis. Provision of information will be limited to the home country regulator of the given investment firm, even where the investment firm provides cross-border services (ISD). These information requirements should normally amount to no more than marginal additional costs to existing firms operating a qualifying system as they are already subject to regulation. The only costs they would incur should be internal.

The regular reporting to the home country regulator following the initial registration of the qualifying system will generate some continuing costs.

18. Costs resulting from transparency requirements**.** The obligation on operators of qualifying systems to make public pre- and post-trade information may also be a source of cost. This information should already be available to users of systems, so cost implications now should be limited, although the exact information provided may need to be augmented as a result of these standards, leading to systems development costs.

However, the most significant change for some systems will arise from making information available to the public at large. This will clearly involve systems costs to put in place arrangements for onward dissemination of trading information. However, it is important to stress that the standards explicitly mark provision for such services to be arranged on a commercial basis. It is therefore likely that direct costs will be offset by the revenue from such data sells.

An important indirect cost is the potential that qualifying systems will lose business as a result of these standards, as market participants that wish to trade in opaque facilities seek to avoid transparency obligations. This may be because of concern about exposing information about large risk positions to the market or a desire to limit the ability of clients who are not direct users of the system to access price information which could be used to inform future negotiations.

The impact of the first of these considerations will be attenuated by ensuring that pragmatic transparency obligations are in place when providing delayed reporting for risk positions.

The risk of additional costs as a result of a more general desire to conduct trading in an opaque environment highlights the very rationale for these standards. CESRs intention is to ensure broad, consistent transparency requirements for regulated markets and qualifying systems. This does, however, raise the risk of costs to both these types of facilities through the potential that trading business may migrate elsewhere. This is why CESR is conducting further work to examine transparency issues for bilateral systems and other trading arrangements. CESR is therefore interested in views on the potential risk of costs arising from regulatory arbitrage in this area.

19. Compliance costs. The implementation of pre- and post-trade transparency may also result in some additional compliance costs for investment firms operating qualifying systems. However, those costs should be moderated where the financial instruments traded on the qualifying system are the same as those

traded on a regulated market. The transparency requirements on that regulated market will form the benchmark for the qualifying system. For some firms, costs could arise in liasing with relevant regulators in respect of regulatory matters relating to trading information. Once again, such costs should be reasonable due to the home country application of the standards.

20. Costs of monitoring user compliance and facilitating market integrity. Operators of qualifying systems should ensure that they have adequate arrangements in place to monitor user compliance with the rules of the system. These arrangements should generate two types of costs. Costs relating to the enhancement of the system's performance to restrict the scope for user misuse and, "human" costs such as the potential increase in staff to provide an appropriate monitoring level of trading activities.

The operator of the system will have to be able to supply trading data to its home country regulator for a broader monitoring of market activity (in addition to the transaction reporting required under Article 20(1) of the ISD). Costs in that area may vary depending on both the nature of the instruments traded on the qualifying system and the characteristics of the wider market in these instruments. In some asset classes, this will not mean a change in practice. To improve market integrity, home country regulators may however consider monitoring the overall market in a particular instrument on a real time basis. Such real-time monitoring could mean that significant costs could be incurred by investment firms operating qualifying systems providing trading in that particular instrument, as they will have to disseminate real time trading data. This potential cost will need to be considered carefully by regulators when deciding on the relevant transparency requirements and weighed against the potential benefits from enhanced transparency. Such costs could be moderated, e.g. by the standards, leaving to the investment firms the choice of the route under which they could elaborate monitoring arrangements.

21. Costs relating to the capacity of the system. Investment firms will have to be able to demonstrate to their home country regulators the efficiency of the system. This will likely amount to costs of auditing the quality of the system and its capacity to deliver the functionality advertised (security, system processes). Additionally, costs may result from the setting up of arrangements for the management of any operational risk and disruption to the system. The additional costs arising from the standard are likely to be moderate in practice in most cases, as basic system requirements are already part of the firm regulatory requirements.

22. Clearing and settlement costs. The costs of providing clarity about respective responsibilities of the operator of the qualifying system and its user for the clearing and settlement of the transactions should be limited to the publication of information on the arrangements in place.

III Inventory of comments

This summary follows the structure of the consultative document. It is divided in three sections:
1. General observations;
2. Comments on the definition of an ATS and;
3. Comments on each question.

The comments in each section are grouped by the category of market participants (exchanges, ATSs, banks and their associations, investment firms and their associations, national consultations and 'others').

List of abbreviations

AFEI	Association Francaise des Entreprises d'Investissement-FRA
APCIMS	Association of Private Client Investment Managers and Stockbrokers - UK
Assosim	Italian Association of Investment Firms - ITA
Barclays	Barclays PLC - UK
BBA	British Bankers Association - UK
CECA	Spanish Confederation of Savings Banks - SPA
CMVM	Consultative Committee – LUX
CRESTCo	Operator of CREST, real-time settlement system - UK
EAMA	European Asset Management Association – UK
FBE	Federation Bancaire de l'Union Europeenne – BEL
FBF	Federation Bancaire Francaise - FRA
FESE	Federation of European Stock Exchanges- BEL
FNH	Norwegian Financial Services Association
FOA	Future and Options Association – UK
HEX	HEX plc, the holding company of Helsinki Exchanges- FI
IPMA	International Primary Market Association – UK
ISDA	International Swaps and Derivatives Association – UK
ISMA	International Securities Markets Association
LIBA	London Investment Banking Association – UK
LMA	Loan Market Assocation - UK
LME	London Metal Exchange- UK
LSE	London Stock Exchange – UK
LIFFE	London International Financial Futures and Options Exchange-UK
NFMF	The Association of Norwegian Stockbroking Companies- NO
SCLV	Spanish Clearing and Settlement System- SPA
TBMA	The Bond Market Association – UK
ASE	Athens Stock Exchange
CSE	Copenhagen Stock Exchange

Reference to a specific country means the summary of comments collected at national level.

List of responses

Exchanges /Reg.markets/Organisations

1) Euronext
2) London Stock Exchange
3) London Metal Exchange
4) London International Financial Futures and Options Exchange (Liffe)
5) Wiener Börse (Austria)
6) Athens Stock Exchange
7) Copenhagen Stock Exchange
8) Helsinki Exchanges (HEX)
9) Bolsa Madrid
10) Bolsa Valencia
11) SCLV (Spanish Clear. & Settlm. System)
12) Intern. Securities Markets Association
13) Interbolsa (Cent Sec. Dep, Portugal)
14) FESE
15) Virt-X

ATSs

1) BrokerTec
2) Instinet
3) ITG
4) Tradeweb
5) MTS Amsterdam
6) EuroMTS

Banks / Bank Associations

1) Bank Austria
2) Bank of Finland
3) Danish Central Bank
4) British Bankers Association
5) London Investment Bankers Association
6) Federation Bancaire de l'union europeenne
7) Association of Danish Mortgage Banks
8) Swedish Bankers Association
9) CECA (Spain)
10) Caja Madrid Bolsa
11) Banco de Sabadel (Spain)
12) Bankinter (Spain)
13) Assoc. of Foreign Banks in Germany
14) Zentraler Kreditausschuss(Germany)
15) Summary of German Consultation
16) Austrian Federal Economic Chamber

Investment firms/organisations

1. Association Francaise des Enterprises d'Investissement(AFEI)
2. Barclays Plc
3. European Asset Management Association
4. The Bond Market Association
5. The Danish Securities Dealers Association
6. The Norwegian Financial Services Association
7. The Assoc. of Norwegian Stockbroking Companies
8. Futures and Options Association
9. International Swaps and Derivatives Org.
10. Italian Association of Cap. Market Operators
11. Loan Market Association
12. Swedish Securities Dealers Association
13. VuV: Assoc. of Independent Asset Managers

Consumer-/Investor Organisations

1) Euroshareholders
2) APCIMS
3) Consumer Agency of Denmark

Others

4) Comité des Marchés des Valeurs Mob.
   (consultative committee of CSSF, Luxemburg)
5) iVentures Capital Limited (soft-/hardware)
6) Austrian Insurance Organisation
7) Austrian Federal Economic Chamber
8) Securities Regulation Fund (Belgium)
9) CREST

I. General observations	1. <u>Exchanges/regulated markets / FESE</u>
	Euronext: The standards that FESCO proposes to impose on ATSs would certainly enhance investor protection and market integrity in financial markets if properly implemented. However, the implementation of such standards will be carried out on a "differentiated" basis leaving to national competent authorities a great degree of discretion in relation to the standards that they would apply to ATSs. Euronext believes that this will result in two major drawbacks: the application of these standards in Europe will most probably be very fragmented and the conditions for a level playing field between ATSs and Regulated Market will not be created.
	LSE is concerned that the proposed standards are likely to result in the over-regulation of ATSs, leading to a stifling of competition and innovation amongst market infrastructure providers, and increased costs to investors. LSE feels that the bipolar regulatory regime as currently operated in the UK, combined with market forces, provide the necessary investor protections.
	ASE: The standards are generally providing the national supervisory authorities with the freedom to implement and to apply them differently. This may lead to discrepancies in regulation as well as in supervision, which are contrary to the EU effort for harmonisation and consistent regulatory approach across Europe. If the differences are important we may face the phenomena of "forum shopping" i.e. an ATS choosing the less demanding regulation and the less strict authority. Given the fact that ATSs do not have any kind of national character (as the exchanges- at least until now), "forum shopping" seems a possible threat.
	The CSE finds that the standards seem to cover relevant areas and gives the competent authorities the possibility to adjust the requirements to the specific systems. Besides, the requirements seem to be a solution until the revision of ISD provides a functional regulation. The Exchange also finds that the comments are preliminary and they reserve the right to elaborate and supplement the standpoints.
	Bolsa Madrid: The document only provides an interim solution to a very complex problem that requires a more precise analysis. The standards of FESCO mention the relationship between the ATS and the wider markets but do not analyse deeply the real impact that ATSs could have in the liquidity, the transparency and the price formation process of the stocks. The concentration of the trading activity has proved to be beneficial in order to get an efficient securities market. Therefore, as ATSs will mean a market fragmentation, market efficiency should be taken into

	account very carefully in the implementation of a framework for ATSs.
	Borsa Italiana: is worried about internalisation that certainly affects the fairness of the market. They would prefer internalisation to be forbidden, but if this is not an option, they would suggest imposing sufficient disclosure. They believe internalisation mechanisms should be specifically mentioned in ATS Rules, and their application should be highlighted in customer reporting and in statistic for ATS users (and, if possible, for the general public). Borsa Italiana wonders why FESCO explicitly excludes from the scope of its deliberations ATSs operated by other entities than investment firms, e.g. by operators of regulated markets themselves. They would prefer an approach that avoids to create different regulatory frameworks between ATSs operated by investment firms and ATSs operated by operators of regulated markets. As a traditional exchange, Borsa Italiana is not afraid of competition coming from new types of market operators but it does not believe that different (and sometimes discriminatory) regulatory playing fields between the players in the same business maybe useful. Borsa Italiana thinks that traditional Exchanges should be free to operate "ATSs" if they believe that, according to their own evaluations, an ATS can be complementary to regulated markets for specific financial instruments and in particular conditions.
	HEX (Helsinki Stock Exchange): The proposed FESCO standards cover only ATSs operated by investment firms. HEX is in favor, from the point of view of the objectives stated by FESCO that the standards should also cover ATSs run by other institutions. At the latest this question should be resolved in the revision of the Investment Services Directive. HEX draws the attention of FESCO to the specific investor protection issues that arise in so called "internalisation" (matching of client orders against the principal book of the investment firm). In these situations the questions of "best execution" arise. HEX finds that adequate standards should be set to minimise these conflicts of interests between investment firms and their clients.
	ISMA: Referring to the Commission's consultation paper on the ISD, ISMA asks FESCO for an interim regime which will not require costly restructuring in the near term, only for that process to be repeated when an adjusted ISD is enacted in a few years time. ISMA further regrets that FESCO has not conducted a realistic analysis of the costs and benefit of its proposals. ISMA suggests that in the new circumstances of the Commission having introduced its proposals for radical reform of the trading process for securities and derivatives FESCO puts forward its standards as a major contribution to the *debate* the Commission has initiated, and to follow up with (and publish) more fundamental research into the risks to which public

	policy objectives may be exposed by the development of various types of technologically sophisticated trading mechanism. At the same time, Member States should not move to implementation of the standards, at least until the broad outline of the resolution to that debate has become apparent. ISMA underlines the importance of two conditions: 1) each ATS must be subject to oversight only by the regulator in its country of origin 2) many of the proposed standards should not be applied to ATSs which provide services solely to dealers and professional investors as defined at least as broadly as in the Commission's consultative paper on the ISD. Another concern relates to the proposed implementation of a new and additional level of regulation only on a sub-set of trading mechanisms defined by its degree of technological sophistication. ISMA believes that this is inappropriate in the current state of technological change in the capital markets in the EU and globally.
	Virt-X: The position of Virt-X is that investors should receive the same amount of transparency and protection for a trade done on an ATS as they receive for trades done on regulated markets. Virt-X believes that FESCO's proposed standards are an important step in this direction. Virt-x Exchange Limited supports the comments made by FESE in its submission to FESCO.
	iVentures Capital Limited/PowerEx believes that ISD and non-ISD companies should be treated with more parity when it comes to passporting a non-ISD firm regulated exchange across FESCO member groups. The ability to passport non-ISD firms operating an ATS will promote regulated competition within markets and maintain market integrity.
	FESE observes that the paper does not directly address the issue of ATSs operated by entities others than investment firms. They argue that for a level playing field the paper should apply to any form of ATS or ECN. FESE strongly suggests and will advocate the regulation of market operators be they "traditional" or "alternative", on the basis of functionalities offered and activities undertaken, judging the risks emerging and the assessment of the level of protection desirable for categories of market participants.
General observations	**2. <u>Alternative Trading Systems</u>**
	BrokerTec is, from the point of view of an operator, concerned that any imposition of regulation should be consistent with the perceived risks posed to market integrity and (as far as possible) simple.
	Tradeweb: According to Tradeweb, key principles in regulating ATSs are as follows: (A) The scope of the standards applying to ATSs of similar profile should, so far as possible, provide a level playing field for all operators of such systems. It is therefore suggested that the proposed

	standards for ATSs should apply to systems operated by regulated markets in the same way as they apply to ATSs operated by investment firms. (B) The term "alternative trading system" is a very wide one, and potentially covers a multitude of different products providing market infrastructure. These may vary by: product; functionality (for example, quote driven versus order driven systems); sophistication of participants; the extent of the trading cycle that they cover (for example, clearance and settlement); and geographic scope of activities. According to Tradeweb, as a consequence, any regulatory regime applying to alternative trading systems needs to be sufficiently flexible to take account of this variety. (C) Regulation of ATSs should be tailored to regulatory risks that they pose. The regulatory risk profile will inevitably vary by reference to the factors mentioned above and the consequences of the failure of such a system.
	EuroMTS sees as a fundamental issue the question if ATS regulations will be standard for all the electronic systems to aspire to or will they be a standard for a sort of "exclusive club". According to EuroMTS the rules should be 'inclusive,' and draw in as many electronic systems as possible and thereby ensure that there is a common minimum standard. EuroMTS believes that regulators should consider certain basic aspects characterising the nature of each ATS in order to correctly apply the proposed standards and take a view as to the adequate level of compliance when applying the proposed standards to the various existing or emerging ATSs. These characterising aspects are: • Products traded • Trading Model (is the system bi-lateral or multi-dealer?) • Participants (is trading inter-dealer, bank to institution, bank to retail etc.?) • Price formation (quote driven, order driven, request for price/quote driven, auction) Upon reviewing the paper EuroMTS came to the conclusion that it generally supports the standards as proposed in the paper but would suggest that certain other points merit consideration, for example; governance; shareholders structure; admission criteria and the Price Discovery/formation process
	MTS Amsterdam convenes itself to brokerage in the professional inter-dealer wholesale market. Introducing the proposed standards would introduce additional requirements, which could result in an unlevel playing field between trades made by telephone and made via MTS Amsterdam while basically brokerage via phone or via an electronic trading platform represents the same business.
General observations	**3. <u>Banks / Banker's associations</u>**

	LIBA fears that a number of aspects of FESCO's approach would not achieve "a properly balanced, predictable, technologically neutral, and consistent approach across Europe to the regulation of trading systems," and could impose unnecessary or damaging burdens on service providers, and could distort the overall European capital market and restrict its development (..) Although FESCO states that its proposals have been informed by the comments of LIBA and other associations on FESCO's previous paper, it is not evident that FESCO's policy has taken full account of our views on such important issues as the need to avoid an over-wide definition of ATSs, the need to take full account of the diversity of systems and the purposes they serve, and the need to ensure that regulatory requirements apply only where there is a clear policy need that cannot be met by other means.
	Bank of Finland: Overall the initiative launched by FESCO seems well structured and would seem to have most beneficial effects for the development of financial markets in the EU (…) however, one should avoid any further fragmentation in interpretation and implementation of those standards at the national level given that it is unlikely to increase market efficiency and would hamper integration.
	The BBA believes that the overall impact of technological change is positive. In view of this the BBA considers that the policy of the EU, and of CESR, the European Regulators Committee, should be to seek to foster technological change and encourage the ability to develop ATSs. This, should lead to a minimalist approach to regulation - both in terms of the number of ATSs regulated and the amount of regulation applied to them if they are regulated. The focus should be on limiting ATS regulatory obligations to ATS systems, which trade a significant volume of a product, or products, to which the Investment Services Directive (ISD) applies and which are used by retail customers.
	The Nationalbank (The Danish central bank) finds that until a revised ISD comes into force, the FESCO proposal could be used as a temporary solution for the present inadequate regulation of alternative trading systems.
	Swedish Bankers' Association (together with the Swedish Securities Dealers Association) is of the opinion that the rational for a special regulation of ATSs is not very clearly stated in the document from FESCO. It might be questioned what particular characteristics exist that differ the ATS service from a more traditional trading services carried out by investment firms and if these particular characteristics call for a special regulation. This ought to be declared in the document and by a clear definition of ATS. As the EC currently is revising the ISD directive it would be wise not to impose any new regulation of the business carried out by investment firms until the revision is finalised (…) As the FESCO approach to ATS is limited to the service given by investment firms and taking into consideration

	that the operation of those entities is regulated by ISD, both the Associations recommend that any new regulation regarding ATS will be included by the revised ISD and should not appear as a separate regulation.
	FBE: The FBE believes the overall impact of the technological change is positive, although the growth of ATSs also carries some risks. The main (short to medium term) risk is that of fragmentation in some markets if there are a large number of ATS entrants. In the long term liquidity will flow to the most successful exchanges and systems. On balance the FBE considers that the policy of the EU, and of CESR should be to seek to foster technological change and encourage the ability to develop ATSs.
	The Association of Danish Mortgage Banks finds that the purpose of the standards is one step in the efforts to implement common standards in connection with cross-border securities trade in the EU. The Association welcomes that overall purpose.
	Summary of German Consultation: The representatives of the German associations generally supported and welcomed FESCO´s initiative to regulate ATSs. There was an agreement that ATSs are going to play an increasing role in the marketplace. In order to ensure adequate investor protection and market integrity, a standardisation of organisational requirements and conduct of business rules for ATSs at the European level was very much welcomed. At the same time, it was stressed that supervisory regulation of ATSs should also provide for enough flexibility to take into account the differences of the systems.
	Zentraler Kreditausschuss shares the view of FESCO that Alternative Trading Systems (ATSs) are going to play an increasingly important role in the marketplace. To effectively protect investors and the integrity of the market and, given the growing entwinement of the European financial markets, standardisation of the organisational requirements and conduct of business rules for such systems at European level is therefore to be welcomed. At the same time, it should be borne in mind that ATSs and the risks associated with their use may differ quite considerably. To achieve differentiated, risk-sensitive application of the standards, which is explicitly endorsed also by FESCO, we feel it is essential that ATSs should be categorised accordingly. For this purpose, the approach outlined by the Commission of Exchange Experts (BSK) at the German Ministry of Finance in its Recommendations for the Regulation of Alternative Trading Systems of May 2001, which makes a general distinction between bilateral systems (counterparty systems) and those with a marketplace function (securities trading systems), could be adopted.
	Bankinter: In general terms, the proposed standards are proper and guarantee the investor’s protection and the transparency of the

	securities markets. Anyway, the qualifying systems should always be operated by an Investment Firm authorised to carry out those activities by the competent authority. One important aspect to be regulated by the competent authority is the responsibilities and the compensation costs in case of trading contingencies. If those issues are not regulated, the investors will probably be charged with these costs. Finally, the users should be informed about the risks of operating in an ATS and these risks should be transmitted to the investors.
General observations	**4. <u>Investment firms/organisations</u>**
	Barclays: The recently published Commission Consultation paper on Revisions to the ISD suggests significant changes to the regulatory regime. It does not seem to be proportionate that any interim regime should require costly rearrangement by investment firms which may very well only have to be repeated once the ISD is revised in a few years time. Barclays sees a move towards regulating trading: they see this is a step change in the scope of regulators' activities and see no compelling argument for this at least as far as non retail customers transactions are concerned. For Barclays its is hard to discern why trading activities which were previously conducted by, say, telephone did not merit any kind of regulation but as soon as these are conducted by internet/PC they do merit regulation. There is a growing acceptance that regulation should be <u>technology neutral</u>. The proposals therefore appear out of step with this.
	EAMA: The members of **EAMA** generally welcome regulation of ATSs provided that it is lighter than for regulated markets. Their main concern is that the liquidity offered by ATSs should not be jeopardised by excessive or inappropriate regulation. EAMA considers that there are several provisions in the proposed standards and commentary, which could jeopardise liquidity.
	TBMA observes that the current consultative paper does not contain any specific feedback on the comments received in response to the September 2000 paper. While FESCO states that the comments have informed the drafting of the current consultative paper, the current paper does not discuss those comments or indicate, except indirectly, why FESCO has chosen to pursue particular avenues despite the comments received. TBMA strongly believes that it is inappropriate for FESCO to press ahead with its own proposals in this area given the likely overlap with the proposed changes to the Investment Services Directive (ISD). Any changes to the regulation of trading systems should be addressed

	as part of the ISD review.
	FOA: The FOA believes that FESCO's policy of "lumping" together all ATS operators, irrespective of their business profile, into a single category and then subjecting them to a single set of "stand alone" standards on the basis only of the fact that they have automated their dealing processes is contrary to past assurances by regulators of <u>not</u> introducing significant shifts in regulatory policy/direction at a time of fundamental change in the trading environment. Conflicts with the current underlying regulatory structures of most member states is deeply insensitive to commercial practice, and conflicts with the European Commission's approach to the regulation of ATSs (which <u>does</u> pay fundamental regard to essential differences in business profile).
	ISDA: The **ISDA** generally supports the submissions by the ISMA, TBMA and LIBA. On the *consultation process,* the ISDA refers to the previous comment in the September paper and observes that a number of the ISDA comments have not been addressed. The June Paper does not explain the policy motives behind the proposed standards in a satisfactory way. The paper lacks both evidence to demonstrate a need for the proposed regulation, and a properly considered cost-benefit analysis. The proposed standards seem very likely to represent what will only be an interim measure. The ISDA observes, referring to the recent Commission paper on proposed revisions to the ISD, that there are indications that the Commission and FESCO are taking significantly differing approaches to the regulation of trading systems. It appears that the same ATS could fall within FESCO's definition of qualifying system and also within the definition of "unregulated market" in the ISD paper. The ISDA strongly believes that any new regulation should be introduced as part of the process of reform of the ISD. The ISDA cannot see any justification for the imposition on ATSs generally (and in particular on those whose users are professional investors) of conduct of business standards beyond those which are contemplated in FESCO's Core Conduct of Business Rules for Investor Protection Project. A most undesirable outcome would be that different Conduct of Business rules will apply to essentially the same business activity depending upon the means of communication through which the transaction is effected. ISDA strongly believes that the final standards should not focus on conduct of business standards, but solely on market integrity issues. According to ISDA, FESCO should adopt a state of origin approach as opposed to a host state approach. A host state approach would 1) face ATSs with overlapping and potentially contradictory rules due to differences in implementation among member states; 2) it would also

	contradict the approach taken to the application of regulation in a cross-border context in the E-Commerce Directive.
	The **LMA** argues that where trading in the instrument via traditional means is unregulated it is inappropriate that regulatory standards should be imposed simply due to the fact that trading is effected electronically. The LMA**,** referring to loans**,** believes that the ATS standards should generally not be applied by member state regulators to systems that facilitate or automate trading in non ISD-instruments, where there is no general consensus that regulatory concerns and issues arise. This would result from the need to comply with standards, as locally interpreted, to allow access to members or users of the relevant systems in those jurisdictions where regulation and the additional standards apply, whilst facing no such additional regulatory requirements when allowing access to members in other jurisdictions
General observations	**5. <u>National consultations</u>**
	Germany: The representatives of the German associations' generally supported and welcomed FESCO´s initiative to regulate ATSs. There was agreement that ATSs are going to play an increasing role in the marketplace. In order to ensure adequate investor protection and market integrity, a standardisation of organisational requirements and conduct of business rules for ATSs at the European level was welcomed. At the same time, it was stressed that supervisory regulation of ATSs should also provide for enough flexibility to take into account the differences of the systems. It was further welcomed that operators of ATSs are generally treated like investment firms within the meaning of the ISD. Concerns were expressed that FESCO rules may be inconsistent with the rules contained in a revised ISD. Any inconsistency, or rather the fact that after adoption of the ISD operations of ATSs might be need to be brought in compliance with the new rules, could lead to uncertainty about the regulatory status, additional work, and finally in additional costs for the ATS operators. Ensuring consistency of the regulatory approaches contained in the FESCO Paper and the ISD was stressed as an important factor for consideration.
	Spain: The Spanish consultation raised the following key issues: a) The scope of the document is not very clear. It should be more expansive, and include a wider spectrum of ATSs, not only those operated by investment firms. After incorporating these changes, the document could make specific recommendations depending on the type of ATS involved. b) FESCO standards should not try to provide a regulatory framework for ATSs operated by investment firms before the ISD has authorised them to operate qualifying systems (it is the ISD that should authorise investment firms to operate ATSs) c) ATSs could reduce the liquidity of the official markets, damaging

	both 1) investors, as they face difficulties obtaining a proper counterpart for their orders, and; 2) issuers, because of the fragmentation of their domestic markets. d) Potential conflicts of interest exist between the investment firms operating ATSs and their clients. As the investment firms operating ATS are both users and operators of the system, they could obtain advantages in their trading activity with respect to the rest of the users of the said trading system. e) The document does not explain exhaustively the clearing and settlement process of the transactions carried out in ATS. Specifically, it does not refer to the requisite of irrevocability of the orders (as defined by Directive 98/26/CE of the European Parliament and the Counsel of May 19) f) Being listed in an official market has a very important impact for the issuer and implies meeting some requirements (periodical information reporting, etc.). Thus, any ATS that wants to negotiate a given stock should ask its issuer in advance. FESCO standards should include the obligation of asking for permission of the issuer before its admission to trading. Similarly, the issuer should be able to ask for the de-listing of its stocks on an ATS.g) Potential asymmetries in the requirements for the disclosure of information for issuers may exist depending on the market (regulated market or ATS) where their stocks trade. The differences in the requirements for information refer both to the information requirements at initial registration and also in subsequent disclosure of required information.
	Sweden: The rational for special regulation of alternative trading systems (ATS) is not very clearly stated in the document from FESCO. It might well be questioned what particular characteristics exist that differentiate the ATS-service from more traditional trading services carried out by investment firms and if these particular characteristics call for special regulation. This ought to be declared in the document and by a clear definition of ATSs. As the European Commission currently is revising the ISD directive it would be wise not to impose any new regulation of the business carried out by investment firms until the revision is finalised. As FESCO's approach to ATSs is limited to the service provided by investment firms, and taking into consideration that the operation of those entities is regulated by the ISD, it is recommend that any new regulation regarding ATSs should be included by the revised ISO and should not appear as a separate regulatory regime. General requirements - as they are proposed by FESCO – is preferred as it leaves much room for the individual investment firm to formulate and disclose whatever rules it has set up for the operation of an ATS service.
General observations	**6. <u>Others</u>**
	APCIMS welcomes the transparent approach adopted by FESCO and believes that it is important for all involved in the consultative

	process to be aware of the comments submitted. In general, APCIMS endorses the aims of the FESCO standards, particularly the standards ensuring that users of 'qualifying systems' are adequately protected and that the 'integrity of the market is protected.' APCIMS raised the following concerns: 1) the cost implication as a result of the introduction of the standards; 2) the absence of risk analysis for different types of ATSs; 3) future market structure must be taken into consideration; 4) the need to have harmonised standards for transparency is vital to have harmonised standards, there is no case for ATSs to be subject to lesser standards than those for regulated markets; 5) the timetable FESCO is pursuing (finalising the proposals by the end of the year) is a very ambitious one. A much more protracted public and consultative debate is desirable; 6) a lack of consistent implementation by all Member States.
	Eurosharehoders observes the following seven key issues in regulating ATSs: 1) Transparency (especially of prices and volumes is the most important criterion guaranteeing fair, efficient and safe markets); 2) Conflicts of interest: the operator must ensure that, in the context of executing customer orders, conflicts of interest are properly handled; 3) System safety; 4) investor protection (without leading to over-regulation); 5) Dangers of over-regulation and high market entry barriers for innovative competitors of established exchanges. 6) Liquidity: Eurosharehoders believes that the disadvantages of market fragmentation must be tolerated in the interest of promoting innovation and competition; 7) Counter-party systems: the introduction of electronic processing of agency operations could lead to blurring of the distinction between market-places and counter-party systems. The difference must be explained for private investors.
	The Consumer Agency of Denmark welcomes the proposal, which will improve the protection of private investors, who trade securities through systems as home banking and bilateral systems where the bank is trading with their customers. The Agency also says that the standards in overall must live up to good marketing practise.

II. Definitions	1. <u>Exchanges/Reg. Markets/ Organisations</u>
	Euronext: The definition of "qualifying systems" can include ATSs carrying out exchange functions but the implementation of the proposed standards will not impose on such ATSs the same obligations as those that Regulated Markets have to comply with, therefore ATSs will have the same rights and even more (e.g. investment firms ISD passport). This dual regime implies either that rules imposed to Regulated Markets are too heavy (and should be revised) or, that rules imposed to order matching Investment Firms are too loose. It is very dangerous to create a regime where competition is distorted and one category of institutions is favoured to the detriment of the other, especially if the category which will suffer from this distortion (the Regulated Markets) wants to remain a reference for the markets. This may start a race to the bottom with respect to market integrity and investor's protection, which Euronext understands is not the aim of the reform.
	ASE: The definition of ATSs is very broad. As the definition covers any possible operator of electronic system, it is not obvious what is the difference between an exchange and any other entity operating a trading system. One could think that difference between a trading system and an ATS may be the regulatory powers attributed to many exchanges (mainly for the listing and the prospectus and partly for the continuous disclosure requirements of listed companies), which enable the exchanges to maintain high standards both for the securities traded and the participants in their markets. However, according to the new draft directives (and the Lamfallussy Report) such powers should be vested in one administrative authority. Therefore the exchanges will be deprived of all its qualitative characteristics and will have to compete with the ATSs, which have advantage to be much less regulated.
	FESE has difficulties in acknowledging the value and the validity of the definition. It is understandable that regulators tend to choose the legal status of an entity (in most cases granted by them) as the key factor when distinguishing between an Exchange and an ATS. FESE proposes the following definition: *"An ATS is an entity operating the Exchange business (or key parts thereof) that gets away with not being regulated like an Exchange."* Being aware that this definition also has its limitations, FESE nevertheless hopes that it can serve as a vehicle to transport FESE's main message in this respect: Exchanges and non-Exchanges ought to be separated along *functional lines* and not according to their legal or even historical status; even less so when efforts are made to harmonise regulation across the 18 jurisdictions of the EEA and beyond. FESE agrees with FESCO that the question of *price discovery* does

	not necessarily constitute a pre-conditional element of distinction between systems operators. Both, price discovering and price taking systems should, under a functional regulatory approach, come under the same set of rules, of course with due regard to their respective areas of activity and the risks involved.
	LSE: The definition of ATSs proposed by FESCO is too broad, potentially including investment firms as they implement efficient, cost reducing automated order handling systems. Further uncertainty is created from the application of standards "in a more differentiated way". This could lead to the arbitrary and inconsistent imposition of standards, by and between regulators.
	LME: The definition of 'qualifying system' could be drawn more tightly. The extent of the current definition would incorporate proprietary trade systems for firms' clients, which 'take' prices from transparent and regulated exchanges and trade them on to their clients. There are no regulatory or investor protection reasons for this type of ATS to be made subject to the standards. The definition needs to isolate those ATSs which are operating as a market and/or which have a price formation function in the wider market for the investment.
	LIFFE: The definition of "qualifying system" is fundamental to ensuring an appropriate policy response to the development of ATSs. The current definition runs the real risk that additional regulatory obligations will be placed upon firms, which are not, in any meaningful sense, operating a market. There is one further element of the definition of qualifying system that causes LIFFE particular concern. This is the fact that the definition covers systems whose operation "results in" an irrevocable contract. LIFFE believes that this wording is too loose because it could be argued that it applies to order routing systems, which is presumably unintended. Given the diversity of ATSs, and the fact that the term has a different meaning to different people, it would be helpful if the ATS standards explained explicitly the types of ATS which are, and which are not, intended to be covered.
	CSE: The Exchange suggests that the definition of an ATS will be more understandable if there were included examples of the generic types of trading systems, which are obtained, for example bulletin boards, crossing networks, dealer execution systems etc. Furthermore, the definition should also include not automated systems.
	Helsinki Exchanges: HEX is in favor of a broad definition suggested by FESCO. In this respect Hex finds the distinction between 'automated' and 'semi-automated' systems somewhat artificial as the same investor protection and other questions arise in both cases. Therefore on question 4 Hex finds that there should be no national discretion on the matter, as the standards should be applied also to semi-automated systems.

	Interbolsa: The *Interbolsa* considers that the reference to 'securities' should be specified regarding the definition of a 'qualifying system'. As systems in this definition, the *Interbolsa* considers that systems by investment firms should comply with the requirement in articles 10 and 11 of the ISD. Additionally, owing to the fact that an ATS that is managed by a management entity of a regulated market is excluded from the scope of the proposed standards, the *Interbolsa* is concerned that this situation does not develop into an excuse for the establishment of more lenient requirements for those entities.
	Virt-X: Whilst Virt-X supports the aim of defining ATSs in a manner general enough to ensure wide applicability, it seems that the definition could be made more specific. In particular, the definition refers only to entities which "bring together buying and selling interests", without any reference to financial instruments. Once the scope of the standards has been determined (i.e., ISD-regulated instruments, commodities, etc.), Virt-X would hope to see appropriate reference made in the definition.
	Bolsa de Valencia: prefers a wider scope for the definition.
	Borsa Italiana: agrees with the proposed definition of ATS, even if, according to the Consob definition (Communication 24th December 1998, n. DM98097747) the ATS shall be both automated and semi-automated and the ATS activity shall be both periodical and continuous. For this reason we believe that systems with bilateral functionality should be considered ATSs instead of automated market-making facilities with a different regulatory framework.
	ISMA: While sympathising with FESCO's desire to go forward with a definition which will 'stand the test of time...', ISMA is strongly of the view that a definition which encompasses almost all trading facilities which replace telephone based interaction between a firm and its clients with computerised management of order flow, and is then used to impose a significant new burden of regulation on such facilities is not justified by the low level of risk which, in most cases, they generate for the integrity of the markets. ISMA would suggest that the costs likely to be imposed on most providers of ATSs as defined are most unlikely to be justified by the benefits to investor and issuer confidence in the markets. If the concern is to preserve the public good benefits that regulated markets are seen to bring to the capital formation process, then we would suggest that a much narrower definition be adopted which more accurately focuses on the public interest concerns, which may exist and which, if so, should properly be dealt with in the near term. To that end we would suggest that the definition of a qualifying system be limited, at most, to systems which consolidate the orders of retail buyers and sellers of equities on a multilateral basis (including systems which consolidate

	orders of retail and professional buyers and sellers) and which, via a mechanism in the trading facility itself, and subject to clear, established, non-discretionary rules, enable such orders to interact with each other and establish irrevocable contracts. A definition along these lines would capture 'quasi' exchanges but would exclude professionals-only systems, brokers who have merely automated their order handling processes and order routing systems and dealers who execute customer orders against their own book, either as part of a formal market making commitment or as a service to customers, but have chosen to do so using technology rather than human intervention.
Definitions	**2. <u>Alternative Trading Systems</u>**
	BrokerTec: The current definition is sufficiently wide to include any automated electronic trading or indeed purchasing (which illustrates the point that it may be that some ATSs are nothing more than electronic brokers), so that effective regulation would revolve around the nature of e-commerce in general rather than require specific rules to apply to such ATSs in particular. The difficulty in attempting to narrow the definition is that it would be difficult to encompass all the operating models that existing automated systems employ. An option might be to define the ATS to which any additional rules apply as being "*an entity that provides an automated system that is an alternative to trading on a regulated exchange but which is not itself regulated as an exchange*". According to BrokerTec, such definition illustrates the point that a fundamental question must be asked – an ATS is an "Alternative" to what?
	ITG: understands FESCO's reason for a broad definition and notes the intention to vary the application of the standards taking account of the different types of qualifying systems. However, ITG believes there will be enormous practical difficulties with this approach given it understands that the parts of the standard that derive their authority from Article 11 of the ISD can be interpreted and applied individually by each national regulator to a single system. ITG fears that very significant resources will be required from both system operators and national regulators to discuss and evaluate each system in each jurisdiction.
	Tradeweb: the term "alternative trading system" is very wide, and potentially covers a multitude of different products providing market infrastructure. These may vary by: product; functionality (for example, quote driven versus order driven systems); sophistication of participants; the extent of the trading cycle that they cover (for example, clearance and settlement); and geographic scope of activities. As a consequence, any regulatory regime applying to ATSs needs to be sufficiently flexible to take account of this variety.

	EuroMTS believes that the definition as stated should draw in as many qualifying systems as possible, which will ensure minimum standards over a greater part of the investment market. However, with specific regard to the definition, reference could be made to buying and selling of "*Investment Products*" to tie in with the link to the ISD qualification. Perhaps also a reference to "*arranges trades*" to include systems who do not execute on their system instead of "*or results in.*"
Definitions	**3. <u>Banks/Bank Associations</u>**
	Banco de Sabadel would define qualifying system as: "an automated system developed by an entity to make possible that different users and operators could make transactions in various financial instruments with the same validity as if these operations where carried out on a regulated market."
	Swedish Bankers Association: The definition is focusing on the entity that operates an ATS and not on the service provided as such, i.e. a system for alternative trading. The Association recommends that the definition should focus on the service provided rather than on the entity. Regarding other services provided by an investment firm, the Association suggests the following wording for the definition : 'a system operated by an investment firm according to its own rules. the firm neither is regulated as an exchange nor as a regulated market, that automatically matches buying and selling orders/interests placed in the system by external users or the investment firm for its own account resulting in an irrevocable contract between a seller and a buyer'
	LIBA: The broad definition of 'qualifying system' gives rise to a danger of over-regulation, since it implies that all the standards could be applied to all qualifying systems except where varied for particular types of system. FESCO should avoid a definition, which would apply all the additional proposed standards to systems purely because they automate a previously unautomated trading procedure. A 'technologically neutral' approach is necessary to avoid inhibiting technological development which will benefit European markets and their users. Application of any new rules should be based on the specific public policy objectives which would be served by ATS regulation, and the specific risks which give rise to justified regulatory concerns. The discussion of factors giving rise to variation in the ATS population, and the Commission's discussion of the delineation of the boundary of 'organised markets' in its consultation on the proposed revision of the ISD, provide a starting point for how the definition issue could be clarified. The definition should take account of the structure which emerges from the Commission's current consultation on the revision of the ISD. The definition of 'qualifying system', and the differentiation of standards should take

	account of the following factors: • Inter-professional trading networks can safely be controlled by market forces; • clients in wholesale markets have sufficient competence and market power that regulatory intervention is not needed to 'protect' them; • retail clients must effectively use a professional intermediary to gain access to organised markets; • interaction with retail customers via user-facing systems is subject to conduct of business rules and disclosure obligations. The broad definition would in effect capture all firms' proprietary trading systems, regardless of whether they were providing an exchange-like multilateral trading infrastructure or were merely an automation of client-facing fiduciary order-matching, and regardless of whether they formed part of a wider market with retail participation or served a specialised inter-professional market. The definition thus risks exposing a large number and wide scope of systems to the possibility of inappropriate requirements where they do not pose a regulatory risk, or where the risks are already catered for by existing obligations.
	BBA: The definition of a qualifying system is critical. The definition, together with the standards required, will set a threshold of additional regulatory costs for electronic trading systems. It is important to bear in mind that in many cases the alternative to "ATS" trading is not "on exchange" trading but "old fashioned" telephone trading. If the EU imposes excessive regulatory hurdles on ATSs - particularly those in markets which traditionally have not been traded on exchanges (such as many eurobonds and swaps) there is a serious risk that participants in the markets will either move outside of the EU or revert to telephone trading. Either alternative will damage prospects for EU wholesale market development and have knock on effects on the retail market. Reversion to telephone trading will not meet the EU objectives for building the premier e-commerce economy. The definition of " a qualifying system" needs to be looked at in this context. BBA would suggest that it should be limited to systems which bring together the orders of retail buyers and sellers of equities and bonds on a multilateral basis and which enable such orders to interact with each other, through the trading system itself, to form irrevocable contracts. Order routing systems, for example, might ultimately result in an irrevocable contract but it is completely inappropriate for them to be regarded as an ATS. In general they simply automate an existing flow of orders to a firm which already had a customer relationship with the order providers. BBA also considers that the definition should be limited to systems of this type which represent a substantial part of the market in the relevant security. Systems which represent only a small proportion of the

	market do not represent a significant regulatory risk. BBA agrees with the German Exchange Experts - who considered that bilateral systems should not be captured within the definition of an ATS. If such systems are members of exchanges, and do not carry out off-exchange transactions, BBA considers that it is not necessary for them to be further regulated - because the rules of the exchanges of which they are members will ensure that appropriate transaction reporting takes place and that the orderliness of the relevant exchange's market is maintained. It is extremely important that the definition of "professional" is sufficiently wide to include sophisticated corporates.
	Bank of Finland welcomes the definition of a "qualifying system". The advantage of this definition is that the U.S. SEC apparently has adopted a very similar definition. As a result room for regulatory arbitrage should decrease between the two main markets and integration of global markets could be enhanced (*Question 2*) as such a regime would facilitate ATSs to function on both markets. Criteria for evaluation of such systems should strictly be common at least in the EEA (*question 5*) for reasons stated above.
	Zentraler Kreditausschuss*:* The definition of ATSs as so-called "qualifying system" is very broad. This means there is a general danger of over-regulation if there is no further differentiation between the different systems and the risks to be addressed. In its recommendations for upgrading the ISD, the European Commission sees a need for regulation of multilateral systems in particular. ZK therefore suggests making a general distinction between systems according to their function as bilateral or multilateral systems. In the case of bilateral systems, a contract is concluded between the counterparties. These systems therefore do not perform a marketplace function, so that there is no specific need for regulation going beyond the provisions of the current ISD. Multilateral systems, on the other hand, have a marketplace function and thus largely correspond in nature to recognised exchanges. For these systems, there is a need for supervisory regulation that is not always adequately ensured by the existing provisions of the ISD. The development of further-reaching standards which could then be incorporated into the ISD at a suitable point thus appears advisable. This approach is also in line with the BSK recommendations mentioned earlier. Regarding the limitations of automated systems, ZK understands that such systems which generally allow the execution of transactions without any manual intervention, e.g. in contrast to the execution of fixed-price transactions in electronic order routing systems. As far as ZK understands, pure order routing systems are not ATSs and do not therefore fall under the definition of "qualifying system". This is also how the European Commission defines "organised markets" in its revision of the ISD.

	Summary of German Consultation: With regard to the broad definition of ATS the general danger of over-regulation was expressed. A distinction between bilateral and multilateral systems was suggested.
	Banco de Sabadel defines a qualifying system as: "an automated system developed by an entity to make possible that different users and operators could make transactions in various financial instruments with the same validity as if these operations where carried out in a regulated market."
Definitions	**4. <u>Investment firms-/organizations</u>**
	Barclays PLC: In principle, Barclays considers that a definition which covers most trading facilities which merely replace telephone based interaction between a firm and its customers with a computerised one and then seeks to impose new regulation on such activities, is flawed as there is no additional risk to market integrity or user protection. Barclays knows that FESCO is aware of industry's concerns about such a broad definition and its far reaching effects. In particular, the wide application of the standards would be disproportionate to the objectives to be achieved. Barclays does wonder whether rather than necessarily revising the definition itself which would be the preferred option, industry's concerns could be addressed by adopting an approach to the application of the standards which assumes that the standard will not apply to an ATS falling within the definition unless certain other triggers are met. Any definition should be technologically neutral and it appears inappropriate to Barclays to introduce a new regulation of trading processes merely because technology has allowed these to be automated where previously they were not. At a very minimum Barclays would like to see substantial misapplication of the standards for systems which are designed for use by professionals or companies which are designated intermediate in the UK.
	TBMA: An attempt to define a class of "qualifying system" requiring additional regulation which is based on the functionality offered by an electronic trading system will lead to the imposition of inappropriate and unduly burdensome regulation. The fact that a service is automated or that it operates according to rules is not in itself a sufficient distinguishing factor that justifies additional regulation of the kind proposed here.
	AFEI: As FESCO recognises, the proposed definition is very broad since it defines as being subject to the proposed standards "an entity

	which, without being regulated as an exchange, operates an automated system that brings together buying and selling interests – in the system and according to rules set by the system's operator – in a way that forms, or results in, an irrevocable contract". The definition of "qualifying system" must hold up to the test of time and evolving practices. This one is not satisfactory, for the following reasons. - The automation criterion is not relevant. Its presence has the effect of excluding from the definition, and thereby exempting from the rules, any entity that brings together buying and selling interests by non-automated means. The mere mode of communication used by the intermediaries cannot justify a difference in the way that the offering of investment services is regulated. - This definition could possibly cover a broad range of systems that raise no greater risks than a "traditional" investment firm. - The discretion allowed to FESCO members in implementing the standards could lead to a situation in which certain systems are considered to be ATSs – and subjected to additional regulation – in some countries but not in others. In view of the foregoing and the problems identified previously, this definition should be revised to better bring out the objectives sought. In particular, it should take into account the nature of the system in question, that is, whether it is a system providing services similar to those of an exchange (a multilateral trading system in which the interests of multiple users are brought together) or rather an automated system serving a relationship between service provider and client. The proposed standards should be justified by the necessity of covering specific risks that are not covered by existing regulation.
	NFMF: The NFMF finds the definition of an ATS very broad. "Automated system", and "brings together" are unclear phrases. Furthermore that it seems unclear whether it is the system as such or the entity that operates that is the important issue. To the NFMF the essence of the definition seems to be automatic matching of orders. If so, this interpretation will exclude systems providing information on orders and trades (such as the NFMF – operated OTS market), order routing systems operated by the various stock exchange members, and systems where investors trade against investment companies own book. NFMF finds such a delimit of the definition necessary, and proposes the following definition of a qualifying system: *An electronic trading – system that, according to rules set by the*

	systems operator, automatically matches buying and selling orders placed in the system by a user in a way that forms or results in an irrevocable contract". NFMF sees a problem that their proposes definition may prove difficult in relation to the definition of an authorised market in the Norwegian Stock Exchange Act. The NFMM sees the essence of this definition as whether one has established a market with an automatic matching system. Such a system would require a license under the exchange act, and a company operating such a system would not benefit from a single passport under the ISD. Depending on the detail in the standards, NFMF does not see severe problems regarding implementation in Norway, as most standards fall within the scope of the Securities trading Act.

	The FNH states that there is no ATS in Norway that fall within the proposed definition, and that therefore it is difficult to have any opinion on the standards impact on the Norwegian market. The proposed definition does not define an ATS as an exchange. FNH considers that an ATS provides services similar to investments services as defined in the Securities Trading Act, and sees it as natural that the Act will apply to such services. On this background the FNH questions the need for the proposed standards. Based on the broad definition, should an ATS be defined to fall within the scope of the Stock Exchange Act, and thus be licensed as an authorised market place, FNH does not see the need for additional standards.
	FOA: The definition of a qualifying system is, as FESCO concedes "very broad". While FESCO states that it has considered its position carefully in this respect and has taken into account concerns raised in response to its earlier consultation, it has clearly not been overly influenced by them (**emphasising the importance of comprehensive and reasoned feedback statements**). A very large number of bi-lateral as well as multi-lateral trading Systems will be the subject of proposed additional standards irrespective of whether they are look-alike exchanges or simply investment firms which have switched from voice-broking to electronic trading with their customers. Such an approach will put a large number of Alternative Trading Systems at real risk of the application of inappropriate rules. For example, many of the suggested standards are simply not appropriate for Alternative Customer Trading Systems Operators and, further, such are the Standards as are appropriate to them are largely already covered in the business conduct and other rules applied to investment firms by individual member state competent authorities. By allowing those standards which are appropriate for Alternative Customer Trading Systems Operators to be incorporated within FESCO's proposed business conduct standards for investment firms, FESCO could then adopt a more limited and market-orientated definition e.g. "**an entity which, without being regulated as an exchange, replicates the role of an exchange by operating an automated system which facilitates buying and selling interests other than itself to come together for the purpose of and to execute transactions on a multi-lateral basis according to rules set by the system's operator**" (cf FOA's proposed reclassification of ATSs in para 1.3 in this response).

	This approach would: (a) accord more closely with the objective of capturing systems which are "trading" systems and not, for example, systems which automate part-only of the trading process (as suggested by **Q.4**); (b) focus on those system operators whose systems provide an "alternative" process to the kind of financial service activity for whom the standards are largely intended i.e. the provision of alternative markets; (c) allow the standards of those ATS operators which have merely automated some or even all of their customer business processes (e.g. order routing systems, the execution of customer orders, market making) to be included as part of the business conduct regime applicable to investment firms (where such standards rightly and logically belong); (d) better reflect the "business line" approach which underpins most existing member state regulatory frameworks and their related rule books as well as FESCO's own approach to the setting of business conduct standards; (e) accord more closely with any "market" extension (i.e. to ATSs) to the scope of instruments covered by the market abuse proposal.
Definitions	**5. National consultations**
	None
Definitions	**6. Consumer Organisations**
	Eurosharehoders agrees that some definitions should be more precise although they need to be sufficiently flexible and robust: users, client, "firm" operating a qualified system (para 17), an "entity" operating a system (par 14), "investment firm" running an ATS (para 13). Question: Is any "firm" or entity" running an ATS automatically an investment firm"? If not, the reference as in para 13 (and others) makes the proposed standards only applicable for "investment firms" and not other "operators". It is important to distinguish between organised trading arrangements and investment firms. The latter were not so clearly defined actually; most present ATS's will continue to be considered as investment firms. The "qualifying" system (para 14). It might be better to put "not unilaterally revocable", implying the possibility to revoke a (concluded) contract if both parties agree.

Definitions	**7. <u>Others</u>**
	COB: Strong concerns were expressed by a bank, as well as by the French Banking Federation about the inclusion, in the definition of ATS, trading systems that are operated internally by banks (or potentially by other financial intermediaries) exclusively trading for their own account. Such "in house" ATSs do not involve any customers, be they retail or professional. They do not raise any concern regarding the investor protection objective mentioned in the FESCO Paper and should therefore be excluded from the scope of the paper, according to some participants. Furthermore, standards should be applied in a differential way, depending on what type of qualifying system is being considered. The main factors to be taken into account when determining the exact requirements for each qualifying system should be the type of users (systems restricted to professional users vs. systems opened to retail users) and the instruments traded (e.g. are the instruments traded admitted to trading on a regulated market ?)

	iVentures Capital Limited believes that a qualifying system would incorporate an automated matching engine that is purely used to match orders and thereby creates an irrevocable contract. An ATS with a final trade confirmation or human interaction support would sit outside this definition. This would also exclude order routing systems.
III Questions	
<u>Question 1.</u> (Conflicts between the Standards and revised Conduct of Business Rules)	*FESCO would be interested to receive views on the interaction between the standards proposed in this paper and the FESCO Consultation Paper on the 'Harmonization of Core Conduct of Business Rules for Investor Protection' (February 2001). which is going on in parallel on the harmonization of the core conduct of business rules, FESCO would be interested in particular, in comments on the scope for any conflict between its approach to conduct of business rules and any of the standards listed below. If there are possible conflicts, how might they best be resolved (e.g. by further differentiation in the application of the proposed ATS standards.*
	1. <u>Exchanges/Reg. Markets/ Organisations</u>
	ISMA welcomes FESCO's proposal to harmonise conduct of business rules based on a distinction between professional investors and retail investors and hopes that as a result of the consultation process FESCO has undertaken it will feel able to go further in broadening the 'professional' category and reducing the number and detail of the rules that will still apply to that business. In that context, ISMA would be concerned whether the provision by investment firms of dealing facilities by means of ATSs was to be subject to rules governing the relationship of the firm to its customers (or 'users' as defined by FESCO) which FESCO will otherwise propose should not be applied. This concern is particularly relevant to standards 2, 3 and 4.
	Interbolsa: The consultative paper on ATSs is essentially aimed at the relationship between the firms operating those systems and their users (which may not necessarily be the investors). The Interbolsa believes that where the ATS users are non-institutional investors, the requirements for the functioning of the ATS should be stricter, and the standards to be established should be applied in regards to the conduct of business rules that financial intermediaries have to comply within their relations with their clients.
	Bolsa Valencia: All matters should be treated individually depending on the different types of ATS and their specific characteristics.
	2. <u>Alternative Trading Systems</u>
	BrokerTec believes a clear differentiation needs to be drawn between the types of users of all electronic systems, and the nature of the

	underlying activity and the relevant regulatory rules drawn accordingly. BrokerTec is concerned that there may be a general mistrust the effectiveness of existing rules when applied to "ATS like" systems (depending of course on a realistic definition), but would argue that the basis upon which ATSs operate are often very different both from an operational and market perspective. The consequence is that it is difficult to suggest practical rules that can be applied equally to all ATS systems (there is not a perfect analogy with other technologies (such as the telephone), but some comparisons may be drawn – BrokerTec would argue that it is the means of delivery and to whom that are the important questions in relation to ATS markets that replace OTC trading. There is a risk that ATS standards that deal with matters covered by the ISD would create confusion for both participants and operators, unless any such standards were treated as interpretative rather than prescriptive. Harmonisation surely aims to make the provisions of authorised services easier within the EU, rather than create a separate layer that may have the effect of discriminating against particular operating models, or ATS with a main location in any member country.
	According to **eructs** the question is very wide ranging and in this response it would prefer to focus on the FESCO Standards themselves.
	3. <u>Banks/Bank Associations</u>
	Caja Madrid Bolsa: Proposal of setting up a multi-disciplinary commission to study and solve the possible conflicts between the approach of the FESCO consultation paper "Harmonisation of Core Conduct of Business Rules for investors Protection" and the standards listed in the document under consultation. The consultation to this commission should be compulsory and its opinion should be binding. Additionally, a special contingency fund should be established to solve economic conflicts.
	Banco de Sabadel: In general, there is no conflict of interest between our approach to conduct business rules and the FESCO standards.
	4. <u>Investment firms-/organizations</u>
	AFEI: As regards investment firms operating an ATS in order to provide investment services electronically, logic would require the applicable conduct rules to be drawn up as part of the effort to harmonise the conduct of business rules for investment firms. There is no reason for more rules to be applied to these firms than to investment firms offering their investment services in more traditional fashion. This approach avoids the risk of having two different bodies of rules applicable to the same service. In any event, protection of system users is not a matter of conduct rules but one of

	"commercial" provisions governed by a contract between the investment firm operating the ATS and the users of that ATS. As regards ATSs offering services like those offered by exchanges, not all of the rules applicable to EIs (suitability, best execution, etc.) are relevant.
	Barclays believes there are two essential issues: ➢ the need to consistently apply differentiation based upon the degree of professionalism of the user with no or very limited standards applying in respect of professional users or systems developed for their use; ➢ a clear statement that home country/country of origin is the approach to be adopted. (That ATSs are only be to regulated by the country of origin being the place where the ATS is established) In this respect, Barclays does not regard the statement at the end of paragraph 10 of the Consultation document that "ATSs operating in local markets shall comply with the relevant conduct of business rules on each and every local market in which they operate, within the scope of the ISD" as being in line with the country of origin approach nor helpful in terms of removing barriers to the internal market. In addition, Barclays wonders about the relationship between this statement and the general principle laid out in the E-Commerce Directive that only country of origin requirements need to be met. Barclays also believe that consideration needs to be given to the way in which these proposals replicate requirements of other legislation, specifically the E-Commerce Directive which would seem to cover the requirements of standard 2 and 3 through a combination of Articles 5, 6, 10 and 11.
	NFMF: The content of the proposed principles and rules regarding conduct of business introduces extremely comprehensive advisory duties on the firms towards their customers, i.e. requirements concerning risk warnings, monitoring of the customers' trading restrictions, investment advice according to the customers "needs" (as opposed to e.g. the customers "requirements") etc**.** It is also drawing a distinct line between advisory-based trading and so called execution only trading, where the latter is characterised by the non-existence of advice from the investment services company. Some of the proposed standards states that the operator shall provide different kinds of information, i.e. standard 4 and 6. If complying with these standards it seems that providing such information can be characterised as providing advisory-based trading and not execution only. The Association thinks

	that this has to be clarified.
	5. National consultations
	For **Eurosharehol**ders the final standards will not alter in any way the overall need for investor protection (especially for private investors). The (specific) rules applicable to ATS (and not to regular exchanges) may not just aim at the restriction of the possibility to establish an ATS in Europe. Investors have a real interest in competition and should not be forced to use non-EU systems, as the only possibility of lower cost and better access, at the risk to have to cope- in case of a conflict - with international (US) law and procedures. If too much burden is put on ATS this might cause a move to the USA or other places. Reporting requirements should not be used as a means to prevent potential competition of ATS to emerge (by imposing unreasonable high costs).
	6. Consumer/Investor Organisations
	7. Others
	iVentures Capital Limited's main concern is as an exchanges provider with a Non-ISD classification, Where iVentures has established an exchange using Internet Exchange technology that incorporates an automated matching mechanism to trade in commodity contracts (forward physical and financial power contracts). iVentures is now investigating the potential to offer cross-border trading within the EU on power contracts and are concerned that SFA authorisation of the exchange within the UK cannot be pass-ported across the FESCO member states. iVentures is not adverse to regulation of ATSs. However, iVentures believes that ISD and Non-ISD companies should be treated with more parity when it comes to pass-porting a Non-ISD firm regulated exchange across FESCO member groups. The ability to passport Non-ISD firms operating an ATS will promote regulated competition within the markets and maintain market integrity.
Question 2 (Definition of a Qualifying System)	*Comments are invited on the FESCO definition of a qualifying system, in particular on how the definition could be made more specific while remaining flexible and durable. FESCO would also appreciate some indication as to the number and scope of systems falling within this definition of a qualifying system.*
	See Section II "Definitions"
Question 3 (Factors that may change the application of the Standard)	*Comments are invited on the above factors and how they should be applied in practice. FESCO would also be interested in any additional factors that regulators should take into account when applying these proposed standards on a differentiated basis.*

	1. <u>Exchanges/Reg. Markets/ Organisations</u>
	Euronext: On one hand, all ATSs (including multiple buying and selling interests matching mechanisms) can potentially fall in the very wide definition of the "qualifying system". On the other hand, for the sake of flexibility, all standards will not apply to all qualifying systems and the national competent authorities are left with the task to "differentiate" between systems in order to evaluate which of the standards should apply. Unless appropriate guidelines would be established (notably, for the treatment of the systems that currently exist), it is very likely that national competent authorities will find it very difficult to "differentiate" between systems and that such "differentiation" will result in an uneven implementation of the proposed standards throughout Europe. This will be problematic in relation to the ISD passport that order matching Investment Firms will be able to obtain. Moreover, as mentioned in the introduction, for systems matching multiple buying and selling interests, the standards are not strong enough. These systems should be submitted to all obligations that regulated markets have to fulfil. Otherwise, the proposed standards create two sets of rules/obligations for the same activity, which is dangerous and not acceptable.
	ISMA : Whether FESCO determines to proceed on the basis of its proposed, very broad, definition, of an ATS then ISMA accepts that all the factors listed are relevant. However, ISMA believes that the application of a narrower definition would be a far more effective way of meeting the public interest in a capital market in which investors and issuers have confidence and which matches global standards of cost and competitiveness. If the broad definition remains, however, then ISMA suggests that the confidence of brokers and dealers who operate ATSs would be buttressed if the final paper were restructured so that these factors no longer reside merely in the commentary to the standards but are set out in an initial section on the principles by which the members of FESCO will exercise their powers over ATSs, including the issues they will take into consideration in applying the standards differentially. At the highest level this should state FESCO's commitment to implementation having regard to the creation of a single European capital market which will encourage innovation, competition and cost-effective solutions while ensuring market integrity, investor protection and systemic stability in a global context. The second principle would enshrine, in some detail, concepts inherent in the factors set out in paragraph 16 of proportionality, materiality and the professionalism of users.
	Interbolsa: The rules applicable to members which are running ATSs should be the same, especially regarding transparency, in order to guarantee an adequate competitive equilibrium.

	Bolsa Valencia: All mentioned factors should be taken into account.
	2. <u>Alternative Trading Systems</u>
	BrokerTec: in relation to issues such as market abuse BrokerTec is concerned that FESCO expects the ATS to impose its own form of regulation upon its participants. In most cases of market abuse one would imagine that conduct relates to more than one source of liquidity, and that if the operation of the ATS is sufficiently transparent this acts as a disincentive to use the ATS for mis-pricing etc. Certain models of ATS may be more susceptible to market abuse than others, and a view should be given to the difficulties ATS operators may have in monitoring all aspects of market abuse (misuse of information is potentially of less relevance on secondary markets, for instance). Users of any system should be capable of trading and settling transactions they enter into on the system, and the rules of the ATS should have some recognition of the "qualifying standard" that users have in relation to each product (regulatory status etc). *To place further standards on ATSs making them responsible for the consequences of a user entering into unauthorised trades would be highly onerous*. BrokerTec would suggest that factors are employed to decide if any further surveillance is, in fact required, so that there is an assumption that no regulation is required unless the relevant ATS falls within specified categories (exchange traded products, unlisted equities, non-professional users etc).
	EuroMTS would suggest that at present there is no way to accurately measure volumes and significance in the fixed income markets thus there would need to be an adequate approach to assess the size of the universe first. EuroMTS would suggest that additional factors that need to be addressed should be: (a) Governance – how are the rules determined, monitored and enforced. (b) Shareholders – does the governance and shareholders composition effectively prevent the establishment of a cartel, or an excessive influence of a selected group of dominant participants, and (c) Admission criteria – are these objective and non-discriminatory (avoiding the presence of entry barriers such as high fees or any tied arrangements) Price Discovery Process – how is liquidity established and does it ensure efficient price formation. All these factors are especially important in addressing the risks associated with the balanced working of those multi-dealer systems where a restricted constituency of controlling shareholders/owners are also the most relevant participants to the system.
	3. <u>Banks/Bank Associations</u>
	Barclays preference would be to limit application by way of a refined

	definition but to the extent that that is not possible then they believe it may be possible to differentiate by one or other of the following factors: ➢ nature of the intended users of the systems ➢ exact nature of the ATS system They believe that, even if an ATS falls within the definition, the initial presumption should be that no additional regulation is required unless certain trigger points are reached. It would be helpful if this was clearly spelled out in the standards themselves rather than being relegated to the associated commentary. Where the objective of the standard is in some way to enhance the protection of users of the system, then there is clearly a need to differentiate by reference to the capacity of the users to protect themselves. In this respect they believe that the three-tier approach adopted in the UK has much to commend it and FESCO will be familiar with the arguments on this issue. Additional regulation would only be proportionate in respect of retail consumers.
	Caja Madrid Bolsa: One of the factors that could be taken into account is the number of non-professional investors.
	4. <u>Investment firms-/organizations</u>
	AFEI: AFEI welcomes a differentiated approach to implementing rules suited to different types of systems, especially one that takes into account: - The nature of the system's users, in particular, whether they are professionals or non-professionals. - The nature of the system itself. As indicated above, ATSs operated by investment firms that are merely offering investment services by electronic means should not be treated in the same way as ATSs offering services similar to those provided by exchanges. The latter, which cannot satisfactorily be covered by the rules applicable to investment firms, may indeed represent integrity risks to the market as a whole. - The representativeness of the system with respect to the market as a whole. From the standpoint of protecting overall market integrity, the size criterion (trading volume in a given instrument / significance of the system relative to the market as a whole) should not be a consideration in the treatment of "exchange-like" ATSs. In this context, AFEI believes it important that ATSs of this type should meet some minimal obligations in terms of transparency. ATSs that do not perform a price discovery function should not be exempted from this obligation. The mere fact that investors have traded or are prepared to trade volume X at price Y (where this price is taken from another market) is information that contributes to the price

	formation process.
	EAMA: The success of some ATS is attributable to the lack of regulation or lightness of regulation compared with that of the regulated exchange. EAMA is therefore opposed to the principle that the extent and nature of requirements should depend on the significance of the system in the overall market for the instrument.
	NFMF believes the main problem is connected to the definition. A lot of systems used by investment services companies operates as order routing systems where all trades are reported to the relevant exchange. The same seems to apply also for systems where clients trade directly with an investment services company against the company's own book.
	5. National consultations
	6. Consumer/Investor Organisations
	Euroshareholders: With a view to introduce a level playing field the same standards to all systems should be applied whenever possible for similar types of services. There should be no discrimination between exchanges and non-exchanges. Securities trading systems should have the option of obtaining the status of a regulated market (e.g. Tradepoint) if they fulfil the requisite conditions of the relevant national authority. The recognition by the national authority has ten to be notified to the European Commission. There is no apparent reason to limit the definition to "automated" systems; also semi - or non-automated systems have to respect the standards
	7. Others
	iVentures Capital Limited's main concern is that an SFA regulated exchange within the UK market operating an ATS is not able to passport this across member states. FESCO should allow passporting of Non-ISD businesses across member states where they are providing cross-border exchange business to market experts within commodity markets, namely energy. iVentures/ PowerEx is concerned that national regulatory authorities could have discretion in applying the framework and this could be used as a barrier to entry to protect local organisations and therefore reduce competition within the member states.
	CREST supports the intention of FESCO to provide a degree of oversight of all ATS. CRESTS has a little difficulty in understanding where the line is to be drawn. Footnote 3 notes that a market-maker may advertise its prices, which are binding and can be accepted on demand, either through a computer system or by telephone. It seems that in the first case the arrangements constitute an ATS. What is less clear is on what grounds the telephone equivalent of such an ATS is not to be treated as an ATS. The fact that messages, which constitute the execution of a bargain, are conveyed in one particular digital form (for example, as a formatted message) rather than another

	(a voice conversation across a digital line) seems rather arbitrary. FESCO may need to consider whether an ATS is not best defined by it having a tightly defined rulebook, which determines whether or not an advertised price constitutes a binding bid or offer. CREST also believes that there is a broad continuum from market making, through broker-dealing to ATS and Stock Exchanges and that standards need to be consistent between them.
Question 4 (Application to Semi Automated Systems)	*Comments are invited on the extent to which national regulatory authorities should have discretion to apply the framework to semi-automated systems.*
	1. Exchanges/Reg. Markets/ Organisations
	Euronext believes that these standards would be useful for all ATSs (if those matching multiple buying and selling interests have to comply with obligations imposed on Regulated Markets). Therefore, it does not see any problem for giving national regulatory authorities the discretion to apply this framework to semi-automated systems, provided that if they match multiple buying and selling interests they have to comply with obligations imposed on Regulated Market. However, in this field also a consistent approach should be also taken throughout Europe.
	According to **Wiener Börse** the framework should also be applied to semi-automated Systems.
	ISMA : thinks that the test should not be whether the system is fully or semi-automated but whether it closely replicates the services provided by a regulated market and whether it thereby puts at risk the public benefits the regulated market provides. After all, there are still some exchanges (including the world's largest, the NYSE). which are only semi-automated. This question also highlights the issue that, unless very sensitively applied, FESCO's approach is likely to inhibit the development of cost effective, technologically sophisticated trading systems in the EEA to meet investor and issuer needs. If a firm can maintain or re-introduce a degree of human intervention into the dealing process and thereby avoid additional regulatory overhead, it will have a clear incentive to do so. FESCO members will then be confronted by sterile discussions with firms as to what 'de minimis' level of human intervention is sufficient to merit semi-automated status. ISMA accepts that, on initial reading, this problem is also inherent in the Commission's proposal but would suggest that the interests of a single EU capital market are better served by resolving the problem once, and not twice in relatively short succession.
	Interbolsa: The standards for trading systems should be the same for automated and semi-automated trading.

	The national authorities may be granted with a margin for the differentiated application of the rules in accordance to the type of ATS' users and the type of instruments traded. However, the compliance with the standards is required in order to ensure market integrity and adequate information regarding the operations carried out.
	Virt-x believes that national regulators should have the discretion to apply ATS standards to semi-automated systems. Lack of automation does not make trading systems inherently less prone to abuse or other problems. Arguably, the opposite is true. Virt-X also believes that any criteria established to guide national authorities in this respect should be broadly framed.
	Bolsa Valencia: Regulatory authorities should have the discretion the framework to semi-automated systems although the definition of qualifying systems only refers to automated systems.
	2. <u>Alternative Trading Systems</u>
	BrokerTec: The BrokerTec System is effectively "semi-automated" as traders must actively decide if they wish to accept an order (bid or offer). As already mentioned, there seem to be a variety of different models that can apply to ATS', and even within the same system. BrokerTec is unsure how FESCO would define what is "automated" or "semi-automated".
	EuroMTS: Semi-automated systems should also be brought under this framework thereby ensuring minimum standards for all investment products, hence their support for the broad definition of qualifying system. If the regulator permits a second group of semi-automated system then it would have to deal with the difficult exercise of providing an adequate definition. Indeed these systems may seek to fall outside the standards proposed or seek lower minimum standards and may be inherently more risky. Risk factors such as the following may exist: (a) Thinly capitalised, especially for many Internet based start-ups, (b) Controlled by a small number of dominant institutions (c) Being developed by entrepreneurs with a particular focus that may not include some of the expensive support requirements, (d) Some are developed with the profit making imperative with an implication that costs will be closely controlled and corners may be cut especially with regard to monitoring and supervising system rules, and protections of customers, and (e) Some may be closely controlled by individual firms who may,

	or may not, be investment firms thus could be endangered by factors totally unrelated to the system in question.
	3. Banks/Bank Associations
	Barclays does not think such a discretion should exist. They believe the difficulties of definition would be even more acute in these instances, how much manual activity is required etc. Additionally, if one of the objectives of the proposals is to "introduce a more consistent regulatory approach across Europe" then allowing individual regulators to choose whether or not to bring certain systems into scope would seem to work against the stated objective. Barclays recognises that question 6 suggests the possibility of developing common criteria, for regulators to apply, which would alleviate but not remove the possibility of differential application by individual regulators. They are not satisfied that a logical case has been made for the need to regulate automated systems where no regulation of un-automated systems is seen to be necessary and accordingly, the case for regulating semi-automated systems must be even weaker.
	Caja Madrid Bolsa: Semi-automated systems should be ruled and supported by a kind of "parent company" composed by, at least by three Investment Firms (or regulatory authorities). It should be considered if the cost benefits analyse may discriminate Semi-automated systems.
	Banco de Sabadel: The regulatory authorities should be able to supervise not only automated systems but also ATS operating as semi-automated systems.
	4. Investment firms-/organizations
	EAMA: Many asset management firms have systems in place for crossing buy and sell orders at market price when, as a result of differing investment objectives, they consider it appropriate to acquire securities on behalf of some clients whilst disposing of the same securities for others. Crossing orders in this way reduces transaction costs for clients. It should be clarified that such systems, even when automated, do not fall within the definition of a qualifying system.
	NFMF: It is unclear what is meant by semi-automated systems, not at least in relation to systems that provides information on quotes and trades as a basis for brokers trading, often operated by information vendors and other companies that are not investment services companies. In our opinion regulatory authorities shall not have any right or obligation to regulate such companies and systems.
	5. National consultations
	None

	6. <u>Others</u>
	iVentures Capital Limited: Both ISD and Non-ISD firms already have stringent requirements to ensure market integrity and iVentures does not believe that it is in anyone's interest to burden market participants with even more notification and reporting requirements. iVentures believes that this will reduce competition in the market for ATS systems as only large companies will have the compliance resources to fulfil the increased market reporting obligations.
	CREST believes that the national regulator will have to form a judgement in each case as to whether a trading system (automated or not) is significant enough either in the price formation process or in terms of its volume or value of business to quality for inclusion.
<u>Question 5.</u> (Application to non-ISD instruments)	*Comments are invited on the extent to which national regulatory authorities should have discretion to apply the framework to non-ISD instruments.*
	1. <u>Exchanges/Reg. Markets/ Organisations</u>
	Euronext does not see problems for giving national regulatory authorities the discretion to apply the framework to non-ISD instruments. A uniform approach in Europe would have to be taken. **Wiener Börse**: discretion should be consistent with regard to the one provided for in the ISD, and the wording of the Standard should be as such as do avoid any discrimination.
	ISMA : In the absence of a clear statement from FESCO as to which instruments it has in mind when posing this question, providing a generic answer is problematic. However, the Commission has proposed a clarification of and extension to the current list of ISD instruments. In that context, ISMA would observe that in the absence of retail involvement, the mere application of technology, and the concentration into a number of pools of liquidity of previously fully fragmented markets does not, in our view, justify the imposition of significant regulatory overhead on trading activity.
	Interbolsa: Non-ISD instruments should be left out of the scope of the standards.
	Bolsa Valencia: Providing some risks appear in the domestic markets, regulators should de able to extend the standards to qualifying systems that provide a trading service in non-ISD instruments.
	2. <u>Alternative Trading Systems</u>
	BrokerTec: To the extent that the activity of an ATS represents an e-commerce means of trading, there is no particular reason to apply FESCO standards to those markets in general. If, however the revisions to the ISD includes such products in the future, there is an argument that market integrity can be served by the extension of any

	standards.
	EuroMTS: Some firms operating or owning trading systems are providing a service in a particular segment of the regulated investment markets whilst also having interests in non-ISD trading. Financial, legal or other difficulties encountered by their non investment business could cause a sudden and unexpected collapse of the regulated system thus the regulator should be allowed the option of requiring information and imposing standards on the entity as a whole. Superequivalence is the right of any national regulator. It should therefore be noted that there is a potential conflict between the revised ISD and the E-Commerce Directive on the concept of Home State Regulation versus Country of Origin Regulation within the European Union. If offering your services on a pan-European basis you do not want to have to adjust the rules of the system according to jurisdiction
	3. Banks/Bank Associations
	Barclays does not believe that regulatory authorities should have discretion to apply the framework to non-ISD instruments. They believe it is hard to see a rational argument for including trading in non-ISD instruments. The very fact that such instruments have been excluded from the ISD means that they do not pose any kind of threat to public policy objectives. Accordingly, there should be no need to include them within the proposed ATS regime. Additionally, such discretion would serve to increase barriers to a uniform single market.
	Caja Madrid Bolsa: The trading of non-ISD instruments should only be permitted in very specific cases, but not in general.
	Banco de Sabadel: National regulatory authorities should have discretion to apply the framework to non-ISD instruments.
	4. Investment firms-/organisations
	AFEI: Such a measure seems unnecessary. - First, it is not a question here of instruments traded mainly by investors that need a high degree of protection, nor of instruments that represent increased risks to market integrity in the broad sense. - Second, because these instruments are not covered by the ISD, they cannot give rise to an offering of services under the passport provision.
	In the opinion of **NFMF,** the standards shall not apply to trading systems for non-ISD instruments. The Association thinks it will be more suitable to evaluate the different characteristics of such instruments from an ISD perspective and, if adequate, include the actual instrument in the Annex to ISD.
	5. National consultations
	None
	6. Others

	iVentures Capital Limited believes that ISD and Non-ISD authorised companies have sufficient guidelines and responsibilities to protect market participants in place already. With regard Non-ISD firms, participants that are using the system have the necessary skills and expertise to make commercial decisions on whether to use a system based on the risks involved and therefore iVentures does not believe that any further regulation is required.
Question 6. (Common Criteria)	*Should common criteria be developed to guide the exercise of discretion in regard to question 3 and 4 above?*
	1. Exchanges/Reg. Markets/ Organisations
	CSE suggests that there should be developed common criterions for the authorities' judgements on ATS.
	ISMA : In order to contribute to the goal of creating a single EU capital market, common criteria for the exercise of discretion would appear to essential. Rooting those criteria in a set of high-level principles, as proposed above, would, in our view, make a further positive contribution.
	Interbolsa: Measure should be adopted leading to the gradual harmonisation of the rules and practices of the market.
	Bolsa Valencia: Yes. Common criteria should be developed to guide the exercise of discretion in regard to question 3 and 4 above.
	2. Alternative Trading Systems
	BrokerTec: The risk with leaving any discretion to national regulators is that the current inequity of treatment of electronic systems could inadvertently be reinforced. For historical reasons there are some jurisdictions within the EU where there is limited choice of settlement location for domestic fixed income products, or rules that inhibit the free access of ATS operators that have "cross border" models to those domestic markets. In order to provide the greatest competition or choice for users of ATS systems, there should be a firm acknowledgement of the primacy of the operator's home regulator in any application of standards.
	EuroMTS agrees that common criteria in the form of a minimum standards checklist would be a worthwhile exercise both for the regulators and the regulated, especially for those firms developing new systems. EuroMTS believes that less sophisticated systems should have access to a set of regulatory guidelines as they develop.
	3. Banks/Bank Associations
	Barclays: The use of common criteria should help to reduce differences in application by various Member State regulators and

	hence produce a more level playing field. It should be made clear that only the country of origin regulator may apply the criteria. As they do not believe a discretion should exist in relation to semi-automated systems, their comments apply to question 3 and differentiating factors.
	Caja Madrid Bolsa: The regulating process should impose the maximum homogenisation level, notwithstanding that could oblige some ATS to modify their characteristics.
	4. Investment firms-/organizations
	AFEI: To avoid any distortion of competition, it is important that common criteria be established so that application of the standards on a differentiated basis is done in a consistent fashion by FESCO members. This highlights the necessity of having a precise definition of ATSs in order to reduce the risk of divergent national regulatory approaches and avoid a situation in which a system is regulated differently depending on which country it is established in. It is also important that the standards be accompanied by guidelines on how the differentiation criteria are to be applied (nature of the investors, nature of the instruments traded, nature of the ATS itself; see § 12 above). In this regard, it would be desirable if the committee of regulators, CESR, were charged with ensuring convergent implementation of these standards, within the framework of procedures that include consultation with the industry.
	5. National consultations
	None
	6. Consumer/Investor Organisations
	Euroshareholders: Rules and procedures of all "qualifying" systems have to be transparent, clear, public and sanctions identified. This is in the interest of all parties concerned.
	7. Others
	iVentures Capital Limited: It is in the interest of the system operator to monitor and ensure that participants are complying with the rules of the system. The monitoring of user compliance is therefore the responsibility of the system operator and not the regulator. iVentures does not believe that participants will use a system unless the system operator can show they have put the correct market and participant controls in place to ensure compliance with the systems rules.
Standard 1.	***Regulatory authorities responsible for the licensing and oversight of investment firms should require firms to register the establishment of a qualifying system, and to notify them (and, where different, the regulatory body responsible for the oversight of***

	markets,) of its key features and significant changes to its operation.
<u>Question 7.</u> (Standard 1: Notification Requirements)	*Should the notification requirements be applied equally to all qualifying systems? How can efficient and cost-effective procedures be set up in order to identify qualifying systems when the respective national requirements are first implemented and when new qualifying systems are set up and to provide regulators with necessary information about other material developments? Are there any additional areas on which the regulators should be given information? To what extent is there any overlap with other notification requirements?*
	1. <u>Exchanges/Reg. Markets/ Organisations</u>
	Euronext: Given that the information obtained by way of this first standard (registration and notification of key features) will be the basis for applying other standards, Euronext believes that the notification requirements should apply equally to all qualifying systems. Concerning the information required, it would be useful for regulators to also obtain information on clearing arrangements and not only on settlement arrangements.
	According to the **Wiener Börse** the following information has to be given by the qualifying system in addition. Information should be required whether the system operates its own price-determination mechanism or whether reference prices are used, if the system operates its own price-determination mechanism this mechanism should be described. In addition information about trading hours/days and on clearing arrangements should be registered as well as information about the liable equity of the operator. Publication of the required information in the host country should be demanded key features should be part of the cross-border notification. Information explained in. Standard 1 and 3 should be available for all operators/participants of a market
	ISMA : As set out, the proposed standard is largely unexceptional. ISMA agrees with FESCO that most of the information sought will be obtained by regulators when a firm which operates an ATS is initially registered and as part of a regulator's on-going supervision of the firm. However, that situation is conditional upon the information being provided only to the regulator in the firm's country of origin. It is also conditional on regulators adhering rigorously to principles of proportionality and materiality. In one respect ISMA thinks the wording of the standard merits clarification. That is the reference to registration of the establishment of a qualifying system. This would seem to imply that FESCO proposes new constraints on registered firms to provide dealing services within one country or within the EEA generally. ISMA trusts that this is unintentional.

	Interbolsa suggests that furthermore the information to be provided regarding the initial registration, a reference should be made to the time of the trading and the existence of agreements on the settlement of the operations and if need be, to the endorsement of the counter-part position.
	Bolsa Valencia: All notifications requirements outlined in standard 1 are necessary at the initial registration of an ATS. Even more, they should be also imposed to Investment Firms operating ATS if they operate in the Spanish jurisdiction and accounts for a material volume or market share here. Thus, Bolsa Valencia considers appropriate the opinion of the CNMV in the footnote number 6.
	Virt-x is not clear as to why standard 1 refers only to a requirement to register the establishment of a qualifying system. The provisions in Standard 1 are appropriate when a qualifying system is making use of its passport rights to operate in a host member state, once the system has been approved by the home Member State. As regulated markets must satisfy their home state regulators of their fitness before being permitted to commence operations, Virt-x would hope that similar scrutiny would be applied to ATSs. Virt-x also believe that the ownership structure of the entity operating the system should be disclosed to the national authority as part of the application/registration process, and material changes to the ownership structure should be notified as and when they occur.
	2. Alternative Trading Systems
	BrokerTec: Notification requirements, should only be required if the relevant operational detail has not already been provided to the ATSs home regulator as part of its usual authorisation. To place any Europe wide responsibility on ATSs to provide information over and above what is provided to the home regulator trade details would be extremely burdensome and potentially deny access to other European markets. Regulators in jurisdictions outside the ATSs home location should be bound by the existing approvals within legitimate parameters (subject to its continuing compliance with its own applicable national COB rules). BrokerTec would certainly say that any such standard should not be at the discretion of the "regulatory body responsible for the oversight of markets" unless private investors are involved and the relevant COB rules applicable. BrokerTec is not certain what additional "risks to users" of ATSs would not be covered by existing COB rules and regulatory guidance. As already mentioned BrokerTec is not sure how ATS standards would be imposed over and above these rules without creating a disproportional burden on operators. Ideally, the revisions to the ISD would be sufficiently drafted to address any identified issues relating to ATS in any event.

	EuroMTS would support the provision of trading volumes and activity information and the other notifications proposed. However, for many firms the provision to the regulator must be on a confidential basis as much of the information suggested would be commercially sensitive thus there should be controls on the Regulator publishing the data. The reference to system design and management should accentuate the specifications for IT security and system reliability and resilience. A minimum industry standard would be a nice proposal but may be difficult to define. EuroMTS suggests the addition of Governance and Shareholder information to the notification requirements. When it comes to identifying qualifying systems the regulator should be granted powers to require password access to investment systems so it might independently audit the system. Obviously these scrutiny powers would have to be rigidly defined and confidentiality must be protected.
	Tradeweb agrees with the explanatory statement that the operation of qualifying systems may present risks to users that are not adequately addressed by existing conduct of business rules and/or regulatory guidance. Furthermore, as outlined above, Tradeweb suggests that registration and notification requirements for ATSs of similar scope be so far as possible harmonised, both to encourage investor confidence and to ensure a level playing field for European ATS operators of similar profile. Tradeweb notes that the consultation paper states that the standard should be applied to all qualifying systems. We would argue that the primary focus of regulation of ATSs should be the protection of investors. The application of the standard should reflect the regulatory risk arising from use of the system: hence, a system (such as TradeWeb Europe) which has as its participants only sophisticated investors with the resources and capacity to conduct their own due diligence on the system, should be subject to a lighter touch regulatory regime where notification (and, indeed, other conduct of business rules) are concerned than, for example, an ATS granting access to retail customers.
	3. <u>Banks/Bank Associations</u>
	BBA takes the view that this standard should be applied in a pragmatic and sensible way. In general the contract which sets out the rules of the ATS for its users will give adequate information about the systems key features. If an ATS is already operating as an investment firm provision of these rules should be an adequate notification. If the ATS is not already authorised then it should be subject to a

	modified version of the existing authorisation process, which is no more onerous than that for investment firms seeking "ordinary" authorisation. The approach taken should be to remove authorisation requirements which are not relevant to an investment firm acting purely as an ATS but include whatever additional requirements are appropriate to provide suitable protection for users and integrity of the wider market in the products traded. Some of the types of information proposed under Standard 1 are potentially too detailed. For example, if the ATS is new the number of users is likely to be uncertain. The primary regulatory needs are to understand whether it is a system focused principally on professional or non-professional users, and its share of the market. Regulators need to be aware of the need to facilitate innovative start-ups in the market. Excessive requests for detail at an early stage may well dissuade an ATS from starting up within the EU. This is an important consideration, which should be weighed against the other considerations of protection for users and market integrity. Once authorisation has been obtained the notification requirements relating to change should be no more onerous than those on other investment firms - with the main criterion being that the regulator should be notified of any "material" change. Article 4 of the E-Commerce Directive says “Member States shall ensure that the taking up and pursuit of the activity of an information society service provider may not be made subject to prior authorisation or any other requirement having equivalent effect” – the regulation should make clear that Standard 1 in no way acts as a pre-requisite to the offering of an ATS service. It should also be made clear that there is no obligation or requirement to provide information to host state regulators at any time. The standard uses the term “significant changes” whereas the final dot point of the explanation uses the term “material changes”. There should also be consistency in use of language. It is unrealistic to require that information should be provided “with immediate effect” as laid out in the last dot point.
	Zentraler Kreditausschuss: In order to create market transparency, they support the call for registration of ATS operators by the competent regulatory authorities. They assume in this connection that operators who already have a banking licence would be exempt from this registration procedure and merely have to notify regulators, prior to putting a system into operation, about the type of trading system operated and the rights and obligations attaching to this system. The registration requirements should also vary according to the type of system operated (multilateral/bilateral) and the risks involved. Any other approach would unnecessarily raise the barriers to market entry and thus ultimately have a harmful effect on competition.
	Caja Madrid Bolsa: In standard 1, the information requirements only refer to users in general. In case that the users are non-professional, the information requirements should be wider.

	Other additional information that could help the regulatory authorities in their supervision task is the result of their economic activity of the Investment Firm operating the ATS and the desegregation of the different financial services provided.
	4. Investment firms-/organizations
	AFEI: This standard needs to be made more precise. There should be no doubt as to the fact that the standard requires notification to, but not authorisation by, the regulatory authorities of the investment firm's home country. The standard should specify which authority is to receive the required information (in our view, the home country authority). There is also good reason to organise cooperation between the authority overseeing the firm that operates the ATS and the authorities overseeing the exchange(s) on which the securities are also traded. The necessity of a more precise definition of "qualifying system" appears once more. Indeed, this definition must be sufficiently clear that the investment firm knows exactly when the questionnaire must be filled out. To facilitate understanding of the questionnaire by the firms that will have to submit it, and to ensure consistent treatment throughout Europe, it would be useful to state explicitly that the purpose of these questions is to determine whether the ATS is a market-type ATS or an electronic tool by which an investment firm offers its services.
	COB: It was stressed that even though standard 1 should apply to every qualifying system, some differentiation should already apply to the periodic information required form ATSs that is mentioned in the accompanying paragraph.
	Barclays has the following comments: ➢ Article 4 of the E-Commerce Directive says "Member States shall ensure that the taking up and pursuit of the activity of an information society service provider may not be made subject to prior authorisation or any other requirement having equivalent effect" – the regulation should make clear that Standard 1 in no way acts as a pre-requisite to the offering of an ATS service. ➢ It should also be made clear that there is no obligation or requirement to provide information to host state regulators at any time. ➢ The standard uses the term "significant changes" whereas the final dot point of the explanation uses the term "material changes". They believe there should be consistency in use of language. ➢ They also consider that it is unrealistic to require that information should be provided "with immediate effect" as laid out in the last dot point. They believe that this Standard could be applied to all qualifying systems as it should provide the information on which the regulator

	and operator can establish which other Standards will apply assuming that a matrix type approach (see Question 3) is adopted.
	TBMA: It is difficult to see that there is a justification for seeking to impose a registration requirement on all qualifying systems, particularly in the case of systems which are not material to a firm's operations or are not "core systems". TBMA recognises that it is legitimate for a firm's home state regulator to require information from a firm, as part of its authorisation process, about the systems that a firm proposes to use to conduct its business. TBMA also recognises that the home state regulator should be able to require firms to keep it informed of significant changes in this information. However, in general, regulators would normally take the view that a firm need only provide information on systems that are in some way material in relation to the firm's operations. It cannot be assumed, especially given the breadth of the definition of qualifying system, that every qualifying system is material in this sense. This is particularly important given that the requirement will apply to the worldwide operations of a firm. In the case of a firm operating internationally through a number of branches, this could be a very onerous requirement indeed, particularly if it operates on a decentralised basis. Regulators should have an adequate market awareness to know when a system (that is not material to the operator) becomes or is likely to become so material to the functioning of the wider market that additional information is required beyond that which will normally be obtained as part of a prudential review. Any requirement to provide information on qualifying systems should be solely a requirement to provide information to the home state authority responsible for licensing and oversight. It should be up to that authority to establish appropriate links with separate local market regulators. However, in the same vein, it is important, to ensure consistency with the E-commerce Directive, that requirements to keep regulators informed as to changes in the systems used by firms should not operate as form of authorisation requirement for the use of electronic trading systems. Under the E-commerce Directive, member states may not make the taking up or pursuit of the activity of an information society service provider subject to authorisation requirements or measures having equivalent effect. With respect to the detailed requirements in relation to information provided on "initial registration": • The standard suggests that the firm must notify all outsourcing arrangements, which relate to qualifying systems. This contradicts the approach generally taken by regulators on outsourcing issues, namely that outsourcing arrangements are only a matter of regulatory concern where they are material to the firm. It is not the case that every outsourcing arrangement relating to an electronic trading system is, by reason of that fact alone, material.

	• Firms cannot be expected to notify the "numbers of users" on first registration (when the system will not in any event be operational). • Firms should only be required to provide information on the types of instruments traded (not the individual instruments themselves). The standard suggests that a firm should always be required to notify its home state regulator of volumes and values traded. This to some extent (at least as regards operations within the EU) duplicates information that will already be provided pursuant to transaction reporting requirements under Article 20 of the ISD (or with respect to systems which provide for execution on an exchange, exchange reporting requirements). In addition, this requirement may well be very burdensome where the system is not designed to capture this type of data. The standard also suggests that a firm operating the system should immediately notify changes to its controllers. There is no need to impose this requirement. The Consolidated Banking Directive and the ISD already have provisions about changes of control of banks and investment firms, which adequately address the issues of control over those entities.
	NFMF: The notification requirements shall not be applied to all systems (depending on the definition, ref above). Even though the information requirements under Standard 1 are related to information that an operator shall provide to regulators the Association points out that it will not be acceptable to require a separate obligation to make pre- and post-trade information available to the public. Companies operating trading systems in connection with their exchange-membership (i.e. order routing systems), have reporting obligations towards the relevant exchange, and additional reporting should be unnecessary.
	5. National consultations
	None
	6. Others
	CREST suggests that the description of "the arrangements for the settlement of transactions" need not be at all extensive, if those arrangements are those generally available to market users of that class of securities. If the ATS obliges its customers to clear or settle in a particular place, or has its own arrangements, then the regulator should require the ATS to provide an economic justification of its decision to restrict its customers' choice of clearing and settlement arrangements, including disclosing any cross-subsidy between the clearing and settlement arrangements and the trading arrangements. The ATS operator should be obliged to describe his procedures in the event of a settlement failure, up to and including default by a participant in his system. This could of course involve reliance on the rules and procedures of the clearing and settlement systems, which its customer uses.

Standard 2	***Investment firms operating a qualifying system should make clear the nature of the relationship between operator and user***.
Question 8. (Relation between Operator and User)	*FESCO would be interested to receive feedback on whether any other specific features of the relationship between operator and user should be required to be covered in the agreement.*
	1. Exchanges/Reg. Markets/ Organisations
	ISMA : As a principle, establishing clarity as between the operator and user of an ATS is essential. Both parties need to be aware of their rights and responsibilities and these should be set out in a formal agreement. In that regard there is some considerable overlap between standards 2 and 3 and ISMA wonders if standard 2 merits its stand-alone status. ISMA notes that FESCO distinguishes between the application of conduct of business rules and the application of these standards but as a matter of good practice, as regards retail users of an ATS, (perhaps individuals with direct access to a retail focused 'execution-only' system), ISMA would be surprised if these rights and responsibilities were not required to be set out in conduct of business rules along with other essential elements of the firm/client relationship. As regards users who are professionals in financial markets, ISMA would maintain that this is a matter for commercial agreement between the parties and not one to be determined by regulation. It is unlikely that a professional user would seek to rely solely on an ATS provider's compliance with its regulatory obligations when establishing its relationship with the provider. Its internal compliance team, risk managers, or (internal or external) counsel will insist upon an agreement, which meets its needs; otherwise it will not participate in the system. While each ATS provider will inevitably seek to secure a high degree of standardisation in such agreements, it will need a degree of consensus among potential users on the acceptability of its desired wording if it is to be successful.
	Interbolsa: The following features should be specified: the nature and periodicity of the information; the responsibility taken on by the management entity (or by a third entity), regarding the operations carried out in the ATS concerned; the clearing and settlement of the mentioned operations.
	Bolsa Valencia: The agreement between operator and user is necessary and should include not only the nature of the relationship between them but also all matters that could be considered important.
	Euronext: Euronext has no specific comments on the information asked. However, Standard 2 and 3 do not specify any evaluation by the regulators of the procedures / rules set up by the ATS. Will an Investment Firm need a formal approval to start business as an ATS?

	If this is the case, guidelines should be given to regulators to induce a uniform implementation in Europe.
	2. <u>Alternative Trading Systems</u>
	BrokerTec finds it difficult to see how the relationship between operator and users of ATS system differs from any other provision of financial services. Operators of systems will almost inevitably wish to have written agreements in place for their own limitation of liability and to provide clarity on the scope of the service provided. For inter-professional systems there is no need to check the trading/intermediary relationship as there will inevitably be much investigation and operational analysis throughout. For any system that has users who are familiar with the markets the requirement for explanation is something so closely linked with the credibility of the system that no external requirement is necessary. From a practical point of view BrokerTec cannot imagine there would be any problem with explaining such dynamics to home regulators and that most authorised firms would have provided their operational details in any event. The most significant factors to which home regulators should address themselves are: the experience of the user/user class, where risk eventually lies in trading on the system (principal or agent or the volatility or liquidity of the underlying assets), and the obligations generated by trading. BrokerTec would imagine that these are already covered by the applicable COB rules.
	According to **EuroMTS** all systems should already require a Terms and Conditions Agreement that define (a) the relationship between the operator and the User and also (b) define the rules that the User must follow when on the system; but perhaps FESCO could prescribe a number of areas e.g. system security, system availability, the criteria to qualify as a User (whether on an open or anonymous basis) etc that must be dealt with in these Agreements.
	Tradeweb agrees with the principle that the rules or terms of business between ATSs and their participants should make clear the nature of the relationship between operator and participant. Tradeweb argues that, in a professional environment, it should be free for participants to establish the commercial terms of that relationship.
	ITG thinks that this standard could often be met by the documentation (e.g. Terms of Business) produced under conduct of business rules and that the standard should state that, just as the standard does not affect these rules, it doesn't necessarily require separate documentation or agreement procedures either.
	3. <u>Banks/Bank Associations</u>

	BBA: This standard should mean no more than that a user should be provided with a copy of the terms and conditions/rules for the use of the system and that these should make clear the responsibilities of operator and user in relation to the system. Systems open only to professional and/or intermediate users should not be subject to this standard. Users in those categories are well able to understand the nature of a contracting process. There should be no additional regulatory burden on the operator of the system. In respect of retail users, such disclosure should not be problematic. The E-Commerce Directive already includes additional information which would have to be provided and if it is eventually adopted, the Distance Marketing of Consumer Financial Services Directive will also require further information to be provided. The Association does not therefore think that it will be appropriate for these additional details to be required by these proposed standards giving rise to regulatory jeopardy.
	Zentraler Kreditausschuss endorses the requirement for the user of a system to be informed by the operator about the nature of their contractual agreement and the resulting risks and obligations when trading on the system. The user's attention should be drawn in this connection particularly to potential risks, e.g. conflicts of interest on the part of the operator or price quotation that is not subject to state supervision, especially where multilateral systems are involved. These requirements will, however, already be largely covered today by the ISD and the provisions implementing it at national level – in Germany, Section 31 of the Securities Trading Act and the rules of conduct for securities services enterprises issued by the Federal Supervisory Office for Securities Trading. The BSK recommends in this connection that Section 31, paragraph 2 (2) be supplemented by guidelines, which could further specify the obligations for individual ATSs.
	Summary of German Consultation: A more detailed distinction between „users" and „clients" was suggested, especially with regard to the standards specifying the duties of the system operator to provide information. Most of the information requirements are believed to be already covered by rules of conduct. A special need for additional information was not seen as far as a professional user is operating for his own account. In case he is acting as an intermediary, he is already subject to special requirements as regards the explanatory information provided to the ultimate client. It was assumed that system operators should be under no obligation to monitor the intermediary´s information policy as currently requested by Standard 4. It was also remarked that „best-execution-rules" are not incorporated in the proposed standards. A solution to this issue should be

	contained either in the ATS Paper or in the Investor Protection Paper.
	Caja Madrid Bolsa: Both parts should be free to set up the nature of their relationship according to the applicable legislation.
	Banco de Sabadel: No other features of the relationship between operator and user should be required to be covered in the agreement. However, this agreement will not exempt the Investment Firm to comply with the conduct of business rules relating clients.
	4. Investment firms-/organizations
	AFEI: Inasmuch as the contract is between the investment firm and its client or user, the investment firm is the operator of the ATS, and the system is not a legal person different from the investment firm. The standard should be made clearer on this point. Furthermore, there should be no duplication here of the conduct of business rules with which investment firms are already burdened, as regards services provided to individual investors. As regards services provided to professional investors, this is a matter for the contract between the investor and the firm rather than for a rule.
	COB: It is noted that an investment firm operating an ATS may be required to have two sets of agreements with the same client. One arrangement would cover the relationship between the investment firm and its client. The second one would cover the relationship between the operator of the system and the user. The parties to both agreements could be the same.
	Barclays has the following comments: ➢ Systems open only to professional and/or intermediate users should not be subject to this standard. Users in those categories are well able to understand the nature of a contracting process and if they choose not to be sufficiently clear about their relationship with the system operator then that is a matter for them to clarify in the courts if necessary. There should be no additional regulatory burden on the operator of the system. ➢ In respect of retail users, such disclosure should not be problematic. The E-Commerce Directive already includes additional information which would have to be provided and if it is eventually adopted, the Distance Marketing of Consumer Financial Services Directive will also require further information to be provided. They do not therefore think that it will be appropriate for these additional details to be required by these proposed standards giving rise to regulatory jeopardy.
	TBMA: In principle it is inappropriate to seek to regulate the content of the contractual terms of business that apply to relationships between a firm and other professional investors.

	NFMF: In our opinion it is obvious that there must exist a written agreement between the operator and the users. The Association doesn't think it will be necessary to regulate in more detail what issues that shall be covered in an agreement.
	5. National consultations
	None
	6. Consumer/Investor Organisations
	Eurosharehoders: The investor has to know exactly what services the operator will provide and what the conditions are (procedures, price,..), what are the procedures and sanctions in case of non-respect of the contract on both sides. The applicable law, the competent courts and the possibility of and rules for arbitrage have to be mentioned explicitly.
	7. Others
	None
Standard 3	***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.***
Question 9 (additional information to be provided to the user)	*FESCO would be interested to receive feedback on whether there is any additional information that the operator should provide to the user, either generally or for systems with specific characteristics.*
	1. Exchanges/Reg. Markets/ Organisations
	Euronext: See response to question 8.
	ISMA's response to this question largely replicates its response to question 8. A regulatory requirement to provide detailed information should be limited to protecting the interests of those who are exposed, either through lack of knowledge, expertise and/or financial resources, to the risk of unexpected financial loss through use of an ATS. ISMA suggests that the interaction between conduct of business rules and the rigorous enforcement of advertising rules to prevent unfair and misleading statements being made to retail investors individually and collectively should in any case be sufficient. As an example of misleading advertising targeted at retail investors, ISMA would quote the frequently used slogan in the United States to sell internet-based dealing set-vices, 'Trade the way the professionals trade'. In fact, professionals do not use the internet (at least as it is found in most homes) because it is too slow, liable to 'crash and too prone to error.
	Wiener Börse: also information on agreements concerning clearing and dispute resolution mechanisms.

	Interbolsa: Information should be provided regarding existing clearing agreements.
	Bolsa Valencia: The information set up in the document is proper in general but there should be specific information requirements according to the specific nature of each qualifying system
	2. <u>Alternative Trading Systems</u>
	BrokerTec: If the ATSs rules deal with eligibility to the system there may be no need to disclose the status of other users (particularly of there is a CCP involved). Brokertec regards most of the points covered here to be more appropriately included in the ATSs own rules, which could be disclosed to home regulators on request. The "risks" inherent in using an ATS that occupies former OTC markets are the same as those connected with any e-commerce solution (such as systems that provide price sources, trade information or collateral calculations). If ATS systems are not robust in terms of technology, users will stop using them and access the market via alternative liquidity pools. To that extent, unless the user is a private customer one would have thought that "caveat emptor" would apply in any case.
	EuroMTS: The standards as proposed are a useful guide, However, it would recommend IT security standards should be addressed with an industry minimum standard if possible. For example Internet Firms could aim for 128-bit encryption. EuroMTS would again urge that information on governance, shareholders and privacy should be provided.
	Tradeweb would emphasise that the level of disclosure required should depend on the nature of the system and sophistication of the participants on the system. Where a participant on the system is a sophisticated institutional investor, it seems unreasonable to require an ATS operator to be required to assist it with compliance with regulation in its own jurisdiction. Tradeweb believes that it is may be appropriate to impose high-level obligations to supply information relating to individual systems to market participants, but these obligations should be tailored by reference to the market in which the relevant ATS operates and the participants using that ATS.
	ITG does not think it is reasonable for operators to have to provide *professional* users with details of *their* duties to report trades. While operators should of course assist users to understand the nature of the system, its operator and their impact on trade reporting matters, given the potential complexity and uniqueness of each situation, ITG doesn't feel its fair to move this obligation of the professional user to the system operator.
	3. <u>Banks/Bank Associations</u>
	BBA: It is important that it is clear that the information can be supplied in standardised form.

	As far as professional and intermediate users are concerned, such issues should be a matter for contractual agreement between them and the operator. Operators should not be subject to regulation on this issue. The public policy imperative for those who are able to be responsible for their own actions does not require regulation other than in respect of retail users. In addition, the E-Commerce Directive already covers a number of these points, for example - Article 10(1)(a) covers the operation of the system; - Article 10(1)(c) covers errors. They argue that the very fact that the E-Commerce Directive has considered this issue and laid down requirements for the provision of information is sufficient for the protection of consumers and does not require additional standards giving rise to regulatory jeopardy. There may also be some duplication of requirements set out in standard 2, any overlap should best be avoided. They do not see that there is any need for a system to disclose to users whether or not the system has an obligation to report transactions to a regulatory authority. The obligation to report is of interest to the regulator but all the user needs to know is whether or not the system is regulated by a member state regulator.
	Zentraler Kreditausschuss: This standard specifies the duties on the part of the system operator to provide information to the user. Zentraler Kreditausschuss believes that it is already in the operator's own interests to induce the (potential) user to trade on his system by providing appropriate explanatory information. For this reason, consideration should be given in general to whether additional regulation is necessary. Moreover, the points mentioned in the paper, e.g. information "on the status of other users", concern mainly multilateral systems, so that appropriate differentiation – also in regard to users – is required.
	CECA: Additional information that the operator should provide to the user: If the system has limits to the trading volume of their clients, the operator of the qualifying system should inform their clients of these limits.
	Caja Madrid Bolsa: Standard 3 mixes legal topics and operational ones and they should be considered separately. Moreover, it may be advisable to set up a handbook of procedures for both operators and users.
	Banco de Sabadel: In general, the information that the operator should provide to the user is enough. However, there should be filters of price and volume to avoid trading errors buy the operator of the system. Those filters may have standard levels that could eventually be changed by the users.

	4. Investment firms-/organizations
	AFEI: It appears to AFEI that this rule ought to be applied differently according to the nature of system users (professional or not). For individual investors, this rule should merely be the translation of existing conduct rules (Art. 11 of the ISD). For professional investors, there is no need for this rule, as its content is such that it belongs in the contract between the firm that operates the system and the user. In any event, as regards information to be provided to the user, AFEI finds it curious that the firm operating the ATS should be required to indicate to the user that it has a reporting obligation. No such requirement exists when the firm and the user trade by telephone.
	Barclays comments as follows: ➢ As far as professional and intermediate users are concerned, such issues should be a matter for contractual agreement between them and the operator. Operators should not be subject to regulation on this issue. The public policy imperative for those who are able to be responsible for their own actions does not require regulation other than in respect of retail users. ➢ In addition, the E-Commerce Directive already covers a number of these points, for example - Article 10(1)(a) covers the operation of the system; - Article 10(1)(c) covers errors. Barclays would also argue that the very fact that the E-Commerce Directive has considered this issue and laid down requirements for the provision of information is sufficient for the protection of consumers and does not require additional standards giving rise to regulatory jeopardy. ➢ There may also be some duplication of requirements set out in standard 2, any overlap should best be avoided.
	EAMA: The information provided on the status of other users of the system should distinguish between domestic, other EU and non-EU. Information should be provided about the costs of effecting transactions. Information should be provided about any taxes payable by users on transactions.
	TBMA: It is especially inappropriate to impose obligations on firms to provide information to professional investors as to the nature of the

	risks involved in trading using electronic systems. The essence of the arm's length relationship between a firm and professional investors is that regulators accept that it is the responsibility of the professional investor to evaluate for itself the nature of the risks that it incurs by trading in a particular instrument or trading in a particular way (and the appropriateness of using a system for any client trading).
	In the opinion of **NFMF**, the provider should supply such information, but the Association cannot not see the reason for giving information to users regarding the status of other users. Neither can the Association see the reason behind the requiring of information on different users reporting obligations to different regulatory authorities.
	5. National consultations
	None
	6. Others
Standard 4	***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.***
Question 10. (education of Users)	*How far is differentiation in the amount and type of information to be provided necessary/reasonable? Is there any additional information that operators should provide or satisfy themselves that it exists? Should operators allow trading in securities where they cannot satisfy themselves that continuous disclosure requirements exist? Do the "Standards on Rules for Harmonising Core Conduct of Business Rules for Investor Protection" provide suitable guidance regarding the content of the information which needs to be provided to users (including dissemination of price-sensitive information affecting the value of the investments)?*
	1. Exchanges/Reg. Markets/ Organisations
	Euronext: Standard 4 imposes on system operators to provide or to be satisfied that there is access to, sufficient publicly available information to unable users to form an investment judgement. The aim of the standard being the protection of investors and market integrity, this standard is significant and operators should not allow trading in securities where they cannot satisfy themselves that continuous disclosure requirements exist, especially when retail investors participate in the systems.
	ISMA would argue that such a standard should be limited to systems targeted at retail investors.
	Interbolsa: The information may differ from the one disclosed by exchanges (e.g. Non-traded exchange instruments). ATSs should

	provide information regarding the characteristics of the traded instruments and if these are able to be traded on the exchange.
	Bolsa Valencia: Although the information available should take into account the nature of the users and the type of instruments traded, in general, high levels of transparency should be required. Moreover, operators should not allow trading in securities where they can not satisfy themselves that continuous disclosure requirements exist.
	2. Alternative Trading Systems
	BrokerTec: For publicly listed securities, commodities or derivatives thereof (including composite products such as basis trades) there should be no additional requirement on the ATS, subject to the usual rules applicable to the user class. For synthetic products that are not already well known within the relevant market, users would require any additional information they felt necessary from the ATS. Those ATS's that effectively duplicate (or aim to duplicate) OTC trading on a "market wide" basis are only vulnerable to price manipulation in conjunction with other liquidity sources in the relevant security, and (if sufficiently transparent) not so vulnerable in their own liquidity pool. Even if prices on an ATS ultimately affect the exchange-traded price, there is surely only an issue for regulators if there is evidence of market abuse rather than usual market dynamics.
	EuroMTS: This is definitely an area where the requirement of the user's level of education should be determined by the regulator and should reflect the type and nature of the system.
	Tradeweb: Dealers on the system are already subject to conduct of business rules governing their dealings with users of the system: to the extent that they need to make disclosures in order to trade a particular instrument with users, they are required to do so as a condition of their subscription agreement by which they have the right to deal through the system (TradeWeb Europe). This being the case, it seems inappropriate that such system should be fixed with disclosure obligations of this nature.
	ITG feels this standard could put a significant and unnecessary burden on system operators if applied inappropriately. They request therefore that its application be set out in more detail and clearer protection put in against 'over' application. For example, it is stated that "it may be less important for a system catering for professional users to provide information on for example, the differences between 'listed' and 'unlisted' securities.." They feel that a more balanced wording to avoid over application would be "it will rarely if ever be required for a system catering for professional users to...'
	3. Banks/Bank Associations
	BBA: In general automated trading systems trade in products which

	are relatively "commoditised" and, therefore, are likely to be simple, rather than complex. The more complex the product the more likely it is to be "one off" and tailored to the needs of a particular person. In such circumstances it is also more likely to be a product for professionals, rather than non-professionals. The Association agrees that it will be less important for a system catering for professional users to provide information on such matters as the difference between listed and unlisted securities and the risks in straightforward commoditised products. They do not believe that there is sufficient public policy justification to warrant a requirement of the type proposed in respect of professional users. They suggest that where an ATS is providing matching services as a member of an exchange – and the securities offered will be treated as on exchange bargains – it should be under no greater disclosure obligations than those applying to other exchange members in respect of those products. A general consideration to be taken into account is the balance between disclosure obligations and the economics of doing business with non-professional customers. Non-professional customers tend to produce low size orders and overall a lower transaction volume than professional customers. Where the amount and expense of disclosure increases there is a risk that competition for non-professional customers decreases because ATSs find that it is uneconomic to offer services to non-professional customers. By the same token it does not make sense to require ATSs to provide more disclosure to professional customers than they really need – since this will result in the European market being uncompetitive relative to other global markets which require less substantial disclosure. As mentioned in their overview comments ATSs provide benefits to non-professional customers in terms of tighter spreads and better prices. The overall impact on the EU economy is likely to be positive. If ATSs wish to offer systems initially available only to professional customers to non-professional customers the non-professional customers, on balance, are likely to benefit from keener prices. The EU economy is likely to benefit from higher transaction flows and greater liquidity as the number of non-professional customers grows. The quid pro quo should be that non-professionals are advised of the risks involved – in the form of some form of risk warning – and are free to choose whether to deal on the system or not. If this approach is not taken the likely outcome is that there will be fewer ATSs and they will tend to focus on professional user systems. In consequence the EU economy will grow less quickly and there will be less scope for building an EU economy with a large number of share holding citizens.

	Zentraler Kreditausschuss: This standard deals with additional public information requirements. System operators are to be obliged in particular to ensure that all the information about the securities traded on their systems that is needed by users to form an investment judgement is publicly available. Subjecting all systems to such a requirement goes too far in our opinion. A clear distinction should instead be made according to which type of system is involved and where the risks – depending on the type of user – lie. If a professional user is operating for his own account, there is no special need for protection. If he is acting as an intermediary, he is subject to special requirements as regards the explanatory information provided to the ultimate client; these, however, solely concern the contractual agreement between them. The system operator remains out of the picture in this case, i.e. besides the information that the issuer is required to provide under the Stock Exchange Listing Directive (80/390/EEC) and, where non-exchange traded but publicly offered securities are involved, under the Issuing Prospectus Directive (89/298/EEC), investors already receive further legally specified information today through the intermediary to enable them to make an investment judgement. There is therefore no need for any additional information requirements for system operators in regard to the securities traded on their systems. Zentraler Kreditausschuss assumes that system operators are under no obligation to monitor the intermediary's information policy. This should be made clear by deleting the words "or be satisfied that that there is access to".
	The **Association of Foreign Banks in Germany** supports FESCO's intent to extend regulation to execution-only systems. Such systems should be made available to both professional and private investors. However, different standards should be applicable to the information made available to these two different groups of investors. They believe it necessary to subject the permissibility of participation of private investors in the execution-only systems to their entry into a contract with an investment advisor.
	Caja Madrid Bolsa: This is a very complex topic and standards should only cover the most basic topics regarding not only quantity (prices, news, etc.) but also quality (information provided to professional vendors, etc.), leaving the balance between offer and demand of information to be set up by operators and users.
	Banco de Sabadel: Operators should not allow trading in securities where they cannot satisfy themselves that continuous disclosure requirements exist.
	4. <u>Investment firms-/organizations</u>
	AFEI: By requiring the investment firm that operates an ATS either to provide sufficient information for users to make an investment

	decision or to verify that such information is publicly available, this standard goes beyond what the ISD calls for and beyond what the system operator is required to do in its capacity as an investment firm. AFEI sees no reason for this. If the objective of this standard is to prevent, in the name of investor protection, the trading of instruments that under national law may not be marketed in a particular country, AFEI believes that the means to achieve this objective is not regulation of ATSs but legislation on public offers of securities. This is already an issue for French investors that wish to acquire stocks traded on the NYSE or NASDAQ. Investment products may not be offered to the public in France unless they are accompanied by a prospectus approved by the COB, regardless of whether the offer is made via an ATS or other means.
	COB: there was no formal disagreement expressed on the standard and the accompanying text. Regarding the question whether operators should allow or not trading in securities where they cannot satisfy themselves that continuous disclosure requirements exist, this is considered by the participants more as an issue for the regulators than for the ATSs themselves.
	Barclays comments as follows: ➢ Most, if not all, ATSs are in the nature of execution only services and as such should not have any obligation placed on the operator of the system to ensure that users are properly informed. ➢ Barclays has previously raised concerns about the application of principles 83 and 84 in the FESCO Consultation on Conduct of Business Rules and those concerns apply equally here. ➢ In any event, such a requirement could not possibly be justified where professional or intermediate investors are concerned.
	EAMA: Although it is generally desirable that there be sufficient publicly available information to enable users to form an investment judgement it is extremely undesirable that investors should be denied the opportunity to buy or sell instruments for which such information is not available. EAMA therefore strongly believe that operators <u>should</u> allow trading in securities even when they cannot satisfy themselves that continuous disclosure requirements exist. EAMA does not believe that ATS should be required to disseminate price sensitive information affecting the value of securities traded by users. They do not interpret the Standards on Rules for Harmonising Core Conduct of Business Rules for Investor Protection as requiring such dissemination.
	TBMA: As already noted, FESCO's conduct of business standards do

	not impose any restrictions on the types of instruments in which a firm can transact business with its customers and counter parties by conventional means. Clearly, there should be no restriction as to the instruments in which a firm can provide trading facilities to professional investors. For example, firms currently trade emerging market securities where it may be difficult to establish whether there is adequate public information. Similarly, firms may trade complex derivatives where it is difficult to make valuation or other judgements about the transaction. Firms may also send orders to exchanges or other markets where the standards of investor protection may fall short of international norms. The fact that a firm makes available electronic trading facilities for trading these instruments should not change the arm's length nature of the relationship with professional investors. It is up to professional investors to satisfy themselves as to whether they have adequate information about a particular instrument (and to contract for advice should they require it). Imposing regulatory requirements on a firm to make clear the risks involved in particular instruments merely because they are traded through an electronic trading system would undermine that clarity of responsibilities. It is inappropriate to extrapolate the "proper market" standards applied to regulated markets and to apply this standard to all electronic trading systems operated by investment firms. Regulated markets are not subject to conduct of business regulation and provide a trading venue, which benefits from the endorsement given by regulators through regulated market status.
	NFMF: See comments to question 1. In addition, they add that requiring that an "operator might have to take responsibility for providing appropriate information to users" regarding information on issuers of unlisted securities is impossible. In Norway the issuer does not have any such obligation to publish information. An implementation of the standard, to cover this, will therefore need changes in the Limited Companies Act.
	5. National consultations
	No response provided.
	6. Consumer/Investor Organisations
	Euroshareholders: The operator: • Has to provide all information on the characteristics of the system possibly having an influence on prices of traded instruments; • Must disclose the rules and conditions for the admission of traded products; • Has to ensure that all information that is made available by or through the system is provided by reliable sources.
	7. Others
	No response provided.

Standard 5	***Investment firms operating a qualifying system should establish trading arrangements that result in fair and orderly trading***.
Question 11. (Different Standards for Different Systems)	*Should there be explicit differentiation between the requirements under this standard for different types of systems? Or should such differentiation be within the remit of the national regulator to determine, depending on the characteristics of the system?*
	1. Exchanges/Reg. Markets/ Organisations
	Euronext: No response provided.
	ISMA : As regards professional users it is highly unlikely that an ATS provider will be successful unless its system meets their needs for fair and orderly trading without the need for regulatory involvement. Whether FESCO has evidence to the contrary it should make it public. As regards retail investors, and systems in which retail and wholesale orders interact on a regular basis (that is quasi-exchange systems), there may be a case for regulatory intervention to secure fairness for all, and a price formation process on which others can rely. The broadness of the ATS definition FESCO proposes to adopt risks promoting excessive regulatory involvement in dealing processes in which the public interest would be better served by relying on the forces of competition. This is particularly the case as regards FESCO's concerns about the execution of mis-priced orders (although the issue is also one of the size of the order and not just its price). In general terms, ISMA takes the view that responsibility for order entry resides with the user and not the ATS provider, although the latter may wish to provide basic mechanisms by which the risk managers within a user can limit the risk to which the user is exposed from trader error. This will be, primarily, through the provision of a facility, which enables a user to impose restrictions on order size or price. Regulators should satisfy themselves in their supervision of users that risk management practices are adequate to minimise the possibility that trader error would put the a user's capital, and hence its existence, in jeopardy. As regards trading on ATSs, care should be taken to have regard for the nature of the investments traded and the circumstances, so that the regulator (or indeed the ATS provider) does not impose its view of what constitutes a legitimate price on the market in preference to the views of willing buyers and sellers. For example, in the midst of the Asian crisis a certain country was, in the view of some investors (but not others), likely to default on its foreign currency debt. In very active trading, over several days, its floating rate bonds fluctuated in price by over 6 points. In normal market conditions that price move in floating rate debt would be of some considerable cause for concern and might have been outside any regulator-imposed parameters of an ATS. In the circumstances of the time, that level of short term volatility was, the ISMA would argue, acceptable and an ATS provider should not be denied the opportunity to profit from the trading activity or users the opportunity to continue trading through a

	more cost effective mechanism than by reverting to the telephone. There are circumstances in which the ISMA agrees that there is a case for imposing, by regulation, more onerous responsibilities on the system. In our view three conditions need to be present. First, the ATS falls within the definition of a quasi-exchange with significant retail involvement either directly or indirectly. Second, it is sufficiently large in a particular market for others to have come to rely on its published prices. Third, other trading mechanisms such as the telephone have been largely superseded or are ineffectual.
	Interbolsa: Differentiation is not necessary. However, the execution of orders by the non-professional users should require that the investment firms which operate ATSs seek the best conditions in the market and not only in the system. In the Portuguese case, the answer refers to an additional rule in which the clients' orders must be executed on regulated markets.
	Bolsa Valencia: FESCO should set up explicit differentiation between the requirements for different types of systems.
	2. <u>Alternative Trading Systems</u>
	BrokerTec: By having rules or standard terms on which ATS participants trade on the system (which would include the prescribed topic, as relevant) fair and orderly trading can be maintained (the main issue being one of the equality of application of those rules). Pricing efficiency would ideally be driven by demand and liquidity on the system, rather than dictated by the ATS operator itself. Different types of system should definitely be treated in different and appropriate ways depending on the system's characteristics and user group, but for that very reason any prescriptive or exclusive regulation would be ineffective.
	EuroMTS: it should be for the system operator to define the methodology for trading on their system, however the methodology used must be fair and the regulator should ensure this. Some national regulators may have differing requirements, thus FESCO standards would be useful. EuroMTS supports the idea that single dealer systems or retail orientated systems should be compelled to provide protections and to ensure trades are conducted within acceptable ranges. For example, the client needs to know that he will benefit if there is an improvement in price on booking a trade, and in general he should be made aware of how orders are processed by the ATS operator.
	Tradeweb considers it vital to the development of the ATS industry that regulation only be imposed on individual ATSs where appropriate. The obligations owed in respect of orderly and timely trading should therefore be the same as those imposed on dealers generally.

	ITG believes the regulatory emphasis, certainly on systems exclusively for professional investors, should be on ensuring transparency of the system rules (as per standard 3) rather than the regulator being required to adjudge weather a particular approach is 'fair.'
	3. Banks/Bank Associations
	BBA: The general principle seems appropriate – although an important issue would be the regulatory philosophy adopted in determining what was "fair" trading. The Association notes the suggestion that "users should also be able to view information on completed transactions". This makes sense where the obligation would be for users to be able to see their own completed transactions on the system. It is not necessary, or appropriate, for users to see the transactions of other participants. Indeed, such an obligation would be likely to drive liquidity out of ATSs and back to telephone trading. To the extent that the ATS has professional or intermediate users, all of the items covered by the standard should form part of contractual relationships and do not require to be regulated. The case is different where users are in the third, retail, category as the ability to negotiate contracts could be limited and therefore a regulatory requirement is not unreasonable but is probably best addressed through conduct of business rules. They do not believe that there should be explicit differentiation between requirements under the standard based on different types of system but as mentioned above, based on the nature of the user. If this approach is adopted, then the national regulator would not need to determine the differentiation in terms of the nature of the system. Clear definition of the categories of investors should be included in the standards, which would limit any regulatory discretion.
	Zentraler Kreditausschuss: Despite the fact that the term "fair" has not been defined precisely, Zentraler Kreditausschuss assumes that this requirement is already taken care of adequately by the ISD and, at national level in Germany, by the Securities Trading Act and the rules of conduct for securities services enterprises issued by the Federal Supervisory Office for Securities Trading. It should also be borne in mind that only high-quality systems will survive in the marketplace in the long run. Disclosure of the trading methodology should satisfy the requirements set under this standard. They also point out that an obligation to ensure that the trading methodology enables users to obtain the best price available on the system can only apply to systems with a marketplace function, since transactions conducted through bilateral systems are negotiated individually and the idea of

	continuous trading is therefore alien to such systems.
	Summary of German Consultation: A need was seen for more publicly available information where the prices and trading volumes generated on ATSs are concerned. In this context, it was proposed to make a distinction according to which type of system is involved. A need for more publicly available information was seen in particular for systems, which perform a marketplace function.
	Association of Foreign Banks in Germany: Standard 5 of the Consultation Paper requires that issuers and investment services firms **disclose information** about their allotment or stabilisation activities to the public **in the prospectus** before such activities have been undertaken. This requirement could provide speculators with the opportunity to exploit the market, thus undermining market integrity. The FESCO Paper provides that information on the stabilisation measures should be **disclosed to the public** after stabilisation has been completed. The purpose of this provision is unclear. In any event such a disclosure made to the market participants may nullify the effect of stabilisation measures. The Association suggests that the post-stabilisation disclosure be made to the supervisory authority and not to the public.
	Caja Madrid Bolsa: The amount of information should be the minimum, trying to reach the balance between offer and demand. In this standard it is advisable to make an explicit differentiation for different types of qualifying systems.
	Banco de Sabadel: Each type of qualifying system should have specific trading arrangements to guarantee market transparency.
	4. <u>Investment firms-/organizations</u>
	AFEI: If the ATS in question is operated by an investment firm that is offering its services electronically, this standard is unnecessary. Like any investment firm, this firm has an obligation to ensure best execution, necessitated by the fact that it is acting as agent for the client and for the account of that client. In this situation, the firm has the capacity to assess the execution of its client's instructions. It is to be expected that it will exercise that capacity in the best interest of its client. If the ATS in question is a market-type system, the user is acting alone. There is no reason to impose a special rule to protect a user that is taking decisions with full knowledge of the rules governing the operation of the ATS. In this situation, the concern is essentially to see to it that the user does have full knowledge of those operating

	rules. For professional users, it is up to them to determine whether the system suits them or not and, if it does not suit them, to negotiate contractual changes with the investment firm operating the ATS.
	COB: It is noted that the "best price" requirement to be met by the operator of the system is different from the best execution requirement to be met by an investment firm under the ISD. The operational distinction between the two is not all that clear to every participant.
	Barclays comments as follows: ➢ To the extent that the ATS has professional or intermediate users, all of the items covered by the standard should form part of contractual relationships and do not require to be regulated. ➢ The case is different where users are in the third, retail, category as the ability to negotiate contracts could be limited and therefore a regulatory requirement is not unreasonable but is probably best addressed through conduct of business rules. ➢ Barclays does not believe that there should be explicit differentiation between requirements under the Standard based on different types of system but as mentioned above, based on the nature of the user. ➢ If this approach is adopted, then the national regulator would not need to determine the differentiation in terms of the nature of the system. Clear definition of the categories of investors should be included in the standards, which would limit any regulatory discretion.
	EAMA: In the comment that users should be able to view information on completed transactions, the information should include only the volume and price of transactions but it should be left to the ATS to decide whether or not to reveal parties to the transaction. EAMA agrees that operators should have arrangements in place to reduce the likelihood of users unwittingly executing trades at prices substantially different from recent prices on the system. Such arrangements are especially important in the case of instruments that have recently had a rights issue, bonus issue, stock split or other corporate action.
	TBMA: Professional investors that are users of electronic trading systems should evaluate for themselves whether the system meets their trading needs or the trading needs of their clients. Regulators should not seek to interpose themselves into these relationships.

	In relation to non-professional users, clearly any trading system should be fair, in the sense of meeting the legitimate expectations of users. In relation to non-professionals the proposed standard goes further by seeking to mandate some form of modified best execution rule. There is no reason to impose additional best execution requirements in these standards when this is already adequately covered by the conduct of business standards. The proposed standard also seeks to mandate particular features of system design. It would require that systems enable users to view completed transactions. However, completed transactions will normally be subject to separate confirmation requirements. In some cases, this may be perfectly adequate especially when combined with normal requirements for the rendering of accounts or reporting to clients. This sort of obligation is best left to market forces to set the level of availability of completed transactions within a particular system. The proposed standard would also require the operator of a system to design the system to include arrangements to reduce the likelihood of users unwittingly executing trades at prices which are substantially different from recent prices in the system. Again, regulators should place primary reliance on market forces to play a role in ensuring that system operators design their systems to be attractive to users, especially where those users are themselves professional investors.
	NFMF: It seems that a condition for standard 5 is that the system does provide matching of orders, and if so it is obvious that this should be fair and orderly. In the comments there are some remarks regarding information to non-professional users. It is unclear what kind of information that is needed. There is also a recommendation that all users should be able to view "information on completed transactions". It has to be clarified that this will only cover information on the users own transactions.
	5. National consultations
	No response provided.
	6. Consumer/Investor Organisations
	Eurosharehoders: Differentiation may be in some cases and for some types of services justified/necessary but has to be transparent and public and agreed on by the national competent authority.
	7. Others
	No response provided.
Standard 6	***Where regulators consider it necessary to maintain the integrity of the broader market in a particular instrument, the investment firm***

	***operating a qualifying system providing trading in such an instrument should be ready to make publicly available, on a reasonable commercial basis, information about quotes and/or orders that the qualifying system displays or advertises to the system users. Similarly, operators should be ready to make available publicly, on a reasonable commercial basis, information relating to completed transactions that the system provides to users*.**
<u>Question 12.</u> (Provision of Trading Data)	*FESCO would be interested to receive feedback on the requirements for pre- and post-trade transparency. To what extent do the requirements represent additional costs for qualifying systems and how do they compare to the requirements of the recognised markets in the relevant instruments? Does the standard strike the right balance between the commercial interests of the system operator and the public interest of the wider market? What factors (e.g. volume) should regulators take into account when considering the importance of a system to wider market integrity?*
	1. <u>Exchanges/Reg. Markets/ Organisations</u>
	Euronext: Regarding the obligation to disclose quotes and/or orders, it is again crucial for European markets that they remain transparent. The fact that this obligation would apply "where regulators consider it necessary to maintain the integrity of the broader market in a particular instrument" is not satisfactory. One should not wait, until there is opacity and fragmentation on the markets, to react. This obligation should be an on-going obligation for all securities traded by ATSs that are also traded on Regulated Markets. In view of the significance of this obligation for the orderly and efficient functioning of European markets, ATSs should have to comply with this obligation even if this induces costs.
	Wiener Börse: the absence of transparency in securities-trading systems may present an obstacle to efficient price formation and lead to information asymmetries. This is the case in particular, when volumes which have relevance in relation to the whole market are settled via such systems. Volume-dependent regulation is however not recommended, since private investors' need for protection does not depend on the size of the market in which they are operating. s absolutely essential to ensure the transparency of securities trading systems. Customers and non-customers of the securities-trading system must be in a position to follow the development of prices and volumes on these markets in a timely manner. The Wiener Börse proposes that providers of securities-trading systems be placed under a duty to publish prices and volumes immediately. In addition, providers of systems which use reference markets as a basis for their price determination must inform market participants of the reference market and the respective price/quote prevailing there, as well as the time at which such price /quote was determined. Since Stock Exchanges are obliged to fulfill comprehensive transparency-

	obligations the Wiener Börse suggests to use existing infrastructure and to stipulate the duty of providers of securities-trading systems to inform the Stock Exchange immediately about transactions corresponding with the duty of the Stock Exchange to publish this transactions. In addition the Wiener Börse proposes that securities-trading systems be placed under a duty to explain to private investors that they are no exchanges and that in particular, they are not subject to any neutral monitoring of their price-determination practices by a public authority.
	LME believes that the standard should apply to all qualifying ATSs and that there should be no threshold related to volume or other variables in determining the importance of an ATS to wider market integrity. Broader factors should be taken into account in defining what type of ATSs should be 'qualifying'. Pre- and post-trade transparency should be provided in real time, as required from all regulated exchanges.
	ISMA agrees with FESCO's statement that 'it is important that trading arrangements are consistent with, and supportive of, the integrity of the broader markets in the instruments traded'. ISMA also believes that it is generally agreed that provisions for pre-and post-trade transparency under the current ISD are highly unsatisfactory and inconsistent. The LME suggests, FESCO is confronted by a dilemma, one that again stems from its proposal to regulate trading not generically but on the basis of the technology adopted. For while the views of investors, banks and investment firms have moved on since the mid 1990s there is still no clear consensus on the benefits of highly transparent markets in all investments. For example, the LME expects that the Commission's proposal that banks report their internalised order flow to a relevant regulated market for publication will generate significant opposition in some quarters. Until the issue of transparency is resolved generally, it seems likely that, were FESCO to proceed with its proposals, many banks that have fully automated their internal order flow and execution systems will revert to semi-automation or even purely manual mechanisms. Independent ATS providers, in some markets, will find it more difficult to attract those professional users who will seek to continue, as they see it, to benefit from the "inefficiencies" created by the lack of transparency in those markets. There is therefore a risk that this selective approach will not meet the laudable objectives of FESCO while inhibiting, for some time to come, innovation in trading technology. Furthermore, there is possibility that different interpretations of this standard by one or more members of FESCO could have the effect of excluding certain ATSs from particular jurisdictions. Although FESCO has stated its collective intention to apply these standards consistently across Europe there is no formal mechanism to ensure that occurs, nor as the LME understands it has there been agreement that application will be only and exclusively by the country of origin regulator. A concrete example here may be helpful.

	For example, an ATS provider wishes to place screens in users offices in three countries to trade securities of issuers incorporated in those countries. Its market research has demonstrated that its target users wish to view only the best bid and offer for any security offered on the system. In discussion with its country of origin regulator this has been agreed as acceptable and consistent with the FESCO standard. However, when it seeks to install screens in the offices of users in a second country, the regulator there objects on the grounds that in order to 'maintain the integrity of the broader market...' the ATS must show the complete order book to users in his jurisdiction. In a third country the regulator, also quoting the FESCO standard, requires the ATS to show the identity of each user who has submitted an order. Clearly it will be impossible for a single system to meet these three requirements simultaneously and the result is likely to be that the provider will limit access to its system to users in his country of origin.
	Interbolsa: The ATS will bear the additional costs with the application of these standards but should disclose all the relevant information to the users.
	Virt-x believes that pre- and post-trade transparency is an essential standard for ATSs, as is the case for regulated markets. Article 21 of the ISD sets forth the minimum requirements concerning the type and timing of information to be published by regulated markets. This Article makes no distinction or dispensation for regulated markets which fall below any threshold of activity other factors. For this reason, Virt-x believe that ATSs should be held to the same ISD standards of information as those, which apply to regulated markets.
	Bolsa Valencia: Although the commercial interests of the system operator are legitimate, the most important is assuring and adequate level of transparency. Among the different factors that should be taken into account when considering the importance of a system to wider market integrity, there are the volume traded in the qualifying system and the type of user.
	2. <u>Alternative Trading Systems</u>
	BrokerTec: When an ATS operator has sufficient "critical mass" in terms of market depth it will have clear motivation to publish order/quote or trade information, either freely or in the form of packaged market data. Any refusal to release information that had a distortative affect on the relevant market could be dealt with under the existing market abuse rules of the national regulator (with a view to the ISD). Pre and post trade transparency are the ideal for some ATS operating models (including BrokerTec) and can be achieved by

	freedom of clearing and settlement and the use of CCPs.
	EuroMTS does provide data relating to trading activity on the system and as with other systems it sells data on a commercial basis, thus there must be some protection of the value of this data when the regulator instructs information to be made available. It supports the provision of data to the regulator, but would suggest that the general disclosure of data be controlled by the owner of the data, except when there is a compelling need for the publication of data to ensure efficiency and transparency in the market place. In addition, the provision of certain data may be commercially sensitive (i.e. trading volumes) to some firms and this must be acknowledged. However, EuroMTS would urge the regulator to ensure that when firms publicise the volumes and liquidity on their system that this information is factually correct. For example, some electronic trading platforms, when advertising the success of their system, may issue statements which "double count" trades. Other issues to be considered are (a) the requirement to provide trading data may become a barrier to entry for new firms when competing with established firms and (b) trade volumes could be artificially enhanced by "trading" between the investor participants, thereby creating an inflated trading record.
	Tradeweb believes that it is important to differentiate between markets in different products for the purposes of establishing to what extent (if any) transparency requirements should apply to ATSs. It is TradeWeb Europe's view that the introduction of ATSs into the field of fixed income dealing should not necessitate the imposition of new regulatory requirements relating to transparency on those markets, unless that transparency is demanded by investors. Tradeweb considers that it should be a principle of the regulation of ATSs that regulation should be proportionate and should not seek to introduce new regulatory requirements where these are not attributable to the particular regulatory risks to which ATSs give rise. Tradeweb see no pressing reason for regulation to intervene with market forces in TradeWeb Europe's market.
	ITG believes the comments following the formal standard may actually go beyond the scope of the standard i.e. the standard deals with making publicly available the information that is displayed to system users. The subsequent comments then refer to the pre- and post- trade transparency requirements of related 'regulated markets' being the 'benchmark' for the system. They believe its something quite different to refer to the 'regulated markets' standard as being the 'benchmark' when previously the comment is that the requirements on the system should be 'no more onerous' than the regulated market standards. At a broader level, ITG feels it is inappropriate (and also an extension of the actual standard) to

	benchmark the disclosure requirements to the relevant regulated markets when the system may be operating in a fundamentally different manner. ATSs are by their nature typically different, innovative, and new and the appropriate level of pre- and post- trade transparency can't be 'benchmarked' from the existing market. For example, a fundamental premise for the significant transaction cost savings POSIT can offer investors is order (as distinct from execution) anonymity.
	3. Banks/Bank Associations
	Bank of Finland: *Question 12* requests feedback on the requirements for **pre- and post-trade transparency**. The Bank of Finland believes that anonymity should be enhanced if it allows for greater liquidity on the market and increase in the number of market participants who guarantee prices in the secondary markets. This applies especially for issues that may have some links to monetary policy. The fight against insider trading and other similar causes could instead be enhanced by special requirement that compels all ATSs to deliver full trade data to the regulator in a defined format and periodicity
	Zentraler Kreditausschuss sees a need for more publicly available information where the prices and trading volumes generated on ATSs are concerned. However, this only goes for trading systems which, like exchanges, perform a marketplace function. They are in favour of disclosure of ATS prices and trading volumes and of the underlying reference prices. This is also in line with the recommendations of the BSK, which criticises the lack of transparency on the part of securities trading systems in this connection. They see no special risks, however, that would justify requiring investment firms operating an ATS to provide information going beyond prices and trading volumes. If more extensive disclosure requirements are nevertheless called for, these should specify exactly which system risks they are designed to meet. It should also be ensured that the requirements in question are much lower than those for exchanges.
	BBA: This standard (in so far as it relates to quotes and/or orders) can be justified if it applies to systems defined in the way BBA has suggested. The justification for applying it would be the "public good" rationale mentioned above. They do not consider that the standard has the same justification if applied to ATSs, which have a relatively small part of the market and, in general, are unlikely to have a significant impact on the price formation mechanism. This would be particularly true of "price taking" ATSs which, for example, take their prices from the principal regulated market. They do not see the same need for post-trade information to be publicly available.
	CECA: Too many information requirements will boost the costs of the system and that will impact in the price formation process because the operator will try to recover those costs by increasing its margins.

	Caja Madrid Bolsa: The most important factor to consider when regulating ATS is the "agility " of the qualifying system to "guarantee" the possibility of trade off with other regulated markets. Setting up very strong requirements to guarantee that the qualifying system work at least as properly as the rest of the regulated markets (regarding order handling), other factors like the information or the volume become secondary. On the contrary, if a given qualifying systems is not so efficient in the procedure of order handling, the rest of the factors become more relevant.
	Banco de Sabadel: Pre and post transparency is essential and although it may imply additional costs for the operator of an ATS, the information disclosure requirements should be very important.
	4. <u>Investment firms-/organizations</u>
	AFEI: The proposal contained in this standard raises the question of just who it is that regulates the "broader market". It would seem that in many cases, the regulators will be the supervisory authorities of all the markets on which the instruments in question are traded, including markets outside Europe. As noted previously, the proposal to require more public information from an investment firm because it is offering its services electronically should be examined with care. In AFEI's view, this standard is justified only for an ATS that participates in the price formation process.
	• **COB:** The CMF considered that the post trade transparency requirements should apply to any ATS trading instruments that have already been admitted to trading on a regulated market and that no discretion should be given in this area to national regulators. • The operator of an ATS trading in instruments admitted to trading on a regulated market agreed to the post trade transparency requirements, which he already implements, but had strong reservation about the pre-trade transparency requirements. Information on quotes and orders, he considers, should be limited to the users of the system. • The operator of an ATS restricted to professionals and trading derivatives products with very large size transactions deemed that any pre or post trade transparency requirements would be totally inappropriate (why is it useful for retail investors to know the price of instruments he would never be in a position to buy and that have no impact on the trading systems open to retail investors?). Any step in that direction would lead professionals to go back to "telephone markets" which do not fail within the scope of the paper.

	Barclays makes the following points: ➢ They believe the key phrase is "the integrity of the broader market" and would regard it as unlikely that an ATS could become such a significant player without making information generally available as a means of encouraging usage. ➢ They contend that where a market is not generally open to retail users because of the nature of the asset class traded, then there will be no public policy interest to defend as the participants will be able to agree terms contractually. ➢ In judging whether the integrity of the broader market has been adversely impacted they consider that a leading indicator will be the proportion of the market as a whole which is being transacted on the ATS. They consider that usage of less than 25% should create a presumption that the ATS cannot affect the integrity of the broader market. It should be for the regulator to show that this is not the case.
	EAMA is strongly opposed to any requirement on ATS to make information about quotes and/or orders that the qualifying system displays or advertises to the system users publicly available as such a requirement could jeopardise liquidity. EAMA is strongly opposed to the principle that where a regulator mandates pre- and post- trade transparency standards for trading on a 'regulated market' in the same instruments as are traded on the qualifying system, those mandated standards will form the benchmark for the qualifying system.
	TBMA: It is not clear what justification exists for imposing this type of standard on a firm merely because it operates an electronic trading system. In any event, these types of disclosure requirement are inappropriate in the context of the fixed income market. TBMA does not consider that it is appropriate for securities regulators to impose these sorts of disclosure requirements in fixed income markets. These markets currently largely operate as over-the-counter markets and issues of fragmentation do not arise. Market forces should provide an adequate solution to any issues that arise. To the extent that, in due course, any electronic trading system obtains a dominant position in any particular market, then normal antitrust rules should be applied to control any abuse of that dominant position. It is unclear why it is appropriate to impose pre- and post- trade transparency requirements on particular market participants merely because they operate an electronic trading system when similar obligations are not imposed on all intermediaries who trade by conventional means. Furthermore, it cannot be the case that one member state should be able to dictate to other member states when they should impose pre-

	or post-trade transparency requirements on intermediaries involved in the trading of particular instruments. Even if member states could agree on which markets require the imposition of pre- or post-trade transparency requirements on all European intermediaries, the fact is that many instruments, in particular fixed income instruments, are now traded globally. At best, those requirements would only capture a portion of that trading and transparency would at best be partial. Opportunities would still exist to avoid those requirements by trading in other venues.
	The **NFMF** can not see the regulatory need for imposing an obligation on the operators to make trading information "publicly available". They refer to the unclear definition of "qualifying system". They can neither see a reason for stating that such publication shall be on "a reasonable commercial basis", not at least when it comes to who shall decide what is "reasonable". Another unsolved issue is whether the information is to be made public on a real time basis or not. Without knowing the answer to this or how detailed information that will be required, it is almost impossible to have an opinion on the cost/benefit or whether the standard "strike the right balance" or not.
	5. National consultations
	No response provided.
	6. Consumer/Investor Organisations
	Euroshareholders: In order not to increase too much costs and complexity for the systems certain factors (as volume, users, ..) could be considered for the rulings. It is important that all transactions are reported and shown in a reasonable time; if a transaction can have an important influence on the market (price spread, volume) obligations should be more severe.
	7. Others
	No response provided.
Standard 7	***Investment firms operating a qualifying system should monitor user compliance with the (contractual) rules of the system.***
Question 13 Monitoring Trading Activity	*FESCO would be interested to receive feedback on the system rules that currently exist and whether these are being monitored by the system operator.*
	1. Exchanges/Reg. Markets/ Organisations
	Euronext: Concerning the enforcement of the rules established by ATSs, in addition to the obligation that ATSs monitor user compliance with these rules, it would be logical to ask them to have necessary means to discipline defaulting users including a mechanism to settle disputes and, as necessary, to report to the regulators.
	ISMA : For most ATSs as defined by FESCO, commercial pressures will ensure that users comply with the rules. Only where there is retail

	involvement should it be necessary to impose a regulatory overlay.
	Interbolsa: As far as Interbolsa knows, there are no ATS' presently operating in Portugal.
	Bolsa Valencia: The supervision of the markets and trading systems has different levels and operators of qualifying systems should be in charge of monitoring the compliance of the rules of the systems. Thus, standard 7 is proper.
	2. <u>Alternative Trading Systems</u>
	BrokerTec: There are two distinct issues tied in to this proposal – firstly the matter of breached obligations between the entities responsible for settlement of trades (which may technically be a breach of the rules of the system but for which the operator if the system is not directly involved), and secondly the misuse of the system by any user. In terms of the misuse of the system, the contractual relationship is one best dealt with between the parties. In the case of the settlement of trades, any breach of rules that had the effect or could have the effect of compromising the market would not be in the interests of the system operator. "Monitoring" is too wide a concept to be applied equally without subjective criteria, but as an illustration BrokerTec can see users orders in any security, market depth, volume traded, unusually low repo rates etc, as a matter of its ordinary procedures. As well as being sent real time confirmations, BrokerTec participants are able to view their own trading positions on the System at any time.
	EuroMTS supports this standard. Failure of observance will generate a complaint to the Sanctions Committee, which is comprised of representatives of the Users, thus the defaulter is judged by its peers (on an anonymous basis) rather than the system operator. Copies of sanctions imposed by the Committee are sent to the regulator. These sanctions are more flexible than merely terminating the right to use the system and can reflect a proposal from the participant to rectify the circumstances that caused the breach. Failure to abide by the rules harms the system but through the sanction system it will also harm the reputation of the defaulting user.
	ITG agrees with this standard and specifically monitor POSIT participants for any indications that a participant might attempt to temporarily increase / decrease the price of a stock in the market in the belief that they can get a large sell/buy order filled in the POSIT match. Such manipulation is of course made extremely difficult and unlikely given the match is run within a 7 minute window and a participant can never be sure of getting a 'fill' within the match.
	Tradeweb argues that the standard be applied in a proportionate manner in relation to the scope for abuse offered by the system, so that firms do not unnecessarily incur compliance costs monitoring a

	system for compliance with system rules where these cannot be broken, or where, by the profile and functionality of the ATS, self-regulation by participants is sufficient.
	3. Banks/Bank Associations
	BBA: Monitoring compliance with the contractual rules of the system should only be an issue for the users and owner of the system. The only exception is where the integrity of the broader market is at risk and this, in our view, reinforces the justification for adopting the definition of "qualifying system" proposed. As an ATS will be an electronic system there should be no difficulty in accessing historic trading data in the short to medium term. The position should remain as it currently is - that an ATS (as a broker/dealer) is obliged to assist a regulator in its inquires and provide it with trading information to assist it. It should have no higher monitoring obligation than other broker/dealers
	Zentraler Kreditausschuss does not see any specific need for arrangements to monitor user compliance with the rules of the system going beyond the provisions of the ISD and the legislation implementing it at national level – in Germany, Section 31 of the Securities Trading Act and the rules of conduct for securities services enterprises issued by the Federal Supervisory Office for Securities Trading. Where bilateral systems are concerned, it can be assumed that it is already in the interest of the operator, as counterparty, to prevent any misuse by establishing a secure trading system. The operator will ensure the orderly operation of multilateral systems as well. Because of the near-exchange nature of such systems, some degree of monitoring is required all the same. This should, however, vary according to the type of system user and be much less strict than exchange monitoring. The extent to which such arrangements apply to an ATS should be made transparent.
	CECA: Nowadays, the Investment Firms operating qualifying systems normally monitor the compliance with the contractual rules by obliging their users to agree with a "User's Agreement". CECA recommends that FESCO could draw up a kind of "Standard User Agreement" that protect equally both the users and the Investment Firms operating qualifying systems.
	Caja Madrid Bolsa: The standards should focus in the establishment of a system able to restrict misuses instead of supervising the compliance with the rules of the system, as a way to avoiding conflicts of interest among the users of the system.
	4. Investment firms-/organizations
	AFEI: In its current wording, this standard imposes an obligation of active monitoring of system users by the investment firm. This is not imaginable, particularly since the investment firm has no means of

	coercion. An obligation to alert the authorities in charge of the operation of the "broader market" to any behaviour contrary to regulations could be imagined. However, quite aside from the questions such an obligation would raise in terms of professional privilege, it should be noted that no similar obligation is imposed on investment firms offering their services by traditional means (i.e. non-electronically). If the standard is merely intended to say that the investment firm must see to it that its rights (as established in the contract between it and the user) are respected, it would seem that this is a commercial matter for the two parties to decide between them. In any event, this standard reveals the limitations of the proposal to regulate ATSs within the inappropriate regulatory framework that applies to investment firms. It illustrates just how useful it would be to establish at least a minimal degree of cooperation between market-type ATSs and regulators in order to prevent "criminal" behaviour.
	Barclays has the following comments: ➢ Monitoring compliance with the contractual rules of the system should be an issue solely between the contracting parties. The only exception may be where the "integrity of the broader market" is put at risk. ➢ To the extent that there are adverse consequences of non-compliance with contractual rules in the external environment then there should be no duty on system operators to police on behalf of the authorities who will have existing powers under other legislation/regulation to address these. ➢ Barclays does not see why "monitoring will be particularly important if non-professional users have access to the system" as the activities of non-professional users are likely to be very small in terms of volume when compared to that of professional users. Accordingly, the adverse external consequences will be much reduced in the case of retail activity and this would imply a reduced need to monitor on a cost/benefit basis.
	EAMA believes that ATS should be required to have clearly defined procedures for determining, and rules governing, the validity of transactions that have been effected in a market abuse situation.
	TBMA does not see the value of imposing a requirement on operators of electronic trading systems to monitor users' compliance with their contractual terms and conditions. It is not apparent what regulatory policy objective is served by imposing a broad ranging and unfocussed obligation of this kind. Operators of electronic trading systems may design their contractual terms and conditions to serve a

	variety of objectives. Regulators should rely on the self-interest of operators to enforce their contractual terms. After all, no similar requirement is imposed on firms with respect to the monitoring of other contractual terms of business. In addition, it is not apparent that the operators' conduct would not be covered by general obligations to treat customers fairly. In relation to users that are professional investors, regulators should leave it to the parties concerned to negotiate the protections that they require. This requirement seems (contrary to the suggestion in Annex A to the FESCO paper) to be one more in the nature of a conduct of business requirement aimed at investor protection rather than a prudential rule.
	NFMF: It is obvious that an operator of an ATS must comply with standard 7.
	5. National consultations
	No response provided.
	6. Others
	No response provided.
Standard 8	***Investment firms operating a qualifying system should, where the regulators require it for the purposes of investor protection and market integrity, be able to establish arrangements with the relevant domestic market authorities to facilitate satisfactory monitoring of the markets in the instruments traded and the detection of market and/or client abuse.***
Question 14. Provision of Data to the Regulator	*Comments are invited on this standard. FESCO would be particularly interested to receive feedback on whether any ATSs currently have market-monitoring arrangements in place.*
	1. Exchanges/Reg. Markets/ Organisations
	Euronext: The scope of this standard is not very clear. It requires that investment firms operating a qualifying system should be able to establish arrangements with the relevant domestic market authorities to facilitate monitoring of markets and detection of market and/or client abuse. Regarding the obligation itself, can FESCO explain what type of problems could prevent the investment firm "to be able to establish arrangements"? Moreover, is a mere possibility to conclude such arrangements sufficient? The notion of relevant domestic market authority should be specified. Is it a public authority with public powers? Is it the control units of a regulated market? Whether this is the latter, an investment firm operating a qualifying system which has created losses to another market will probably not want to be monitored by an entity that may later ask for damages.
	ISMA : It is of course reasonable that operators of ATSs should be willing and able to cooperate with regulators and other judicial authorities to minimise market abuse, insider dealing, money laundering etc. Indeed, all firms which provide

	financial services have such an obligation to do so. The key to a cost-effective mechanism by which ATS operators can contribute to this task lies in the definition of 'relevant domestic market authorities' in the standard. ISMA would suggest it would be neither reasonable, nor effective, for an ATS provider, which, for example, provides a trading facility for securities of issuers incorporated in many EEA countries and with a similarly dispersed user group, to have to develop bilateral arrangements with regulators in each relevant country. ISMA would strongly urge that the obligation be limited to making effective arrangements with the provider's country of origin regulator and for the members of FESCO to continue to strengthen their own arrangements for mutual assistance and the exchange of information through FESCOPOL and in other ways. That way, the country of origin regulator would act as a clearing house for requests for information and would be best placed to ensure that a response is adequate, timely and appropriate.
	Interbolsa: The supervision of ATSs should not be based on an agreement, but as the carrying out of a power by the competent authorities. Information disclosure should be seen as an obligation imposed on entities that manage ATS'.
	Bolsa Valencia: The relationships and interactions between qualifying systems and regulated markets will require a strong co-operation between them, and therefore, standard 9 is very important in order to assure market integrity.
	2. <u>Alternative Trading Systems</u>
	BrokerTec: This proposed standard has serious implications for any ATS that operates a cross border model within its regulatory consent inside the EU (the alternative being the establishment of separate local entities in the less accessible markets – which can create vertical silos and restricted market access). At worst, the opportunity for monitoring by domestic authorities could be seen as protectionist, and otherwise could lead to unequal treatment and restriction of competition of ATSs within jurisdictions that are unfamiliar with the relevant ATS markets. Any provision of financial services should be subject to the passport of the relevant firm, and any suggestion that ATS (as differentiated from any other service provider) should be subject to "satisfactory monitoring" is potentially very wide. Part of the difficulty of any electronic service provision is the "regulatory location" of that service, but to be inhibited from trading or be faced with additional burdens in the location where the ATS screen is located seems to go against the concept of "freedom of movement of services". BrokerTec suggests that this proposal would only be required to enforce local COB rules, as it is difficult to see that it would otherwise enhance market integrity or freedom of access.

	EuroMTS supports the regulator in its monitoring of the markets and the imposition of standards but again suggests that there should be differentiation according to the product type and participant base.
	TradeWeb stands ready to liase with its regulators to facilitate the detection of market abuse by, for example, provision of data to regulators. However, Tradeweb would emphasise that the detection of market abuse, and enforcement against market abusers, should be a matter for the competent regulators regulating market participants rather than for ATSs.
	ITG: ITG Europe is a member of 3 exchanges and complies with all associated trade reporting arrangements and also completes transaction reporting in respect of all trading to destinations agreed with its Home country regulator. In principle, ITG has no issue in making these transactions reports available to other domestic market authorities. An issue does however arise where the domestic market authorities are national exchanges (now typically demutualised) which view the system operator as a competitor and may as a result apply the reporting requirements (or charge for reporting) unfairly. With the current changes in market structure ITG believes it would be preferable if acceptance of trade reports and market monitoring could be assigned to a party independent from the competing execution venues.
	3. <u>Banks/Bank Associations</u>
	Bank of Finland supports the idea of Standard 8 whereby ATSs could be required to establish arrangements with the relevant domestic market authorities to **facilitate satisfactory monitoring of the markets** in the instruments traded and the detection of market and/or client abuse. However, given that the major ATSs operating in the European markets trade - or are likely to trade in the future - securities issued in a number of countries, they should also be able to provide monitoring data on issues already listed in another country than its home country. Therefore the Bank of Finland would also insert under this standard that at least significant ATSs should be able to make this data available to the relevant authorities of the issuer's home country. In order not to burden the ATS operators too much, a public body may need to be designated to concentrate data collection and its distribution to the relevant local public authorities
	BBA: It is reasonable that operators of ATSs should be willing and able to cooperate with regulators in their investigations into possible infringements such as market abuse. In an EU context the approach should be that the home state/country of origin regulator who has authorised the ATS is the central point through which an ATS provides such regulatory co-operation. Otherwise there will be substantial duplication and scope for confusion – both for the ATS itself and for the member state regulators. The Association suggests that there is scope for FESCO/CESR to facilitate such arrangements through its Lamfalussy "Level 3" role.

	Zentraler Kreditausschus: Market monitoring can generally only take place in the case of trading systems that perform a marketplace function. Regulation going beyond the provisions already in force is unnecessary in their opinion.
	The **Austrian Federal Economic Chamber** believes that the detection, deterrence and punishment of market abuses is the core responsibility of the securities commission/competent authority and in no case ATSs should be responsible for taking any steps, which go beyond supplying of trading data. Therefore the wording of Standard 8 "to establish arrangements [...] to facilitate satisfactory monitoring of the markets in the instruments traded and the detection of market and/or client abuse" does not mean that ATSs have to take over certain responsibilities from the competent authority.
	4. <u>Investment firms-/organizations</u>
	AFEI: This standard runs into the problem of shared responsibility among the authorities in charge of overseeing the "broader market". In addition, it concerns primarily those ATSs capable of having an impact on the price formation process (§26). As regards investment firms offering investment services via an electronic platform rather than by telephone, rules already exist pursuant to Art. 20 of the ISD.
	COB: There was some uncertainly/misunderstanding as to what was intended to be covered by the word "arrangements" used in the standards. It is understood that any additional reporting requirement would not duplicate the ones already in place under article 20 of the ISD.
	Barclays has the following comments: ➢ This standard seems to be bound very closely with the requirements, which may come out of the proposed Directive on Market Abuse. ➢ There is significant industry disquiet regarding that proposed Directive and the agreement of any Standard for ATSs should follow from, rather than pre-empt, conclusions on the Market Abuse Directive. ➢ Any obligations should only be in respect of the country of origin regulator.
	EAMA: ATS may not be open continuously and EAMA does not believe that there should be any requirement for them to be open continuously. It should be clarified that the comment relating to a system's ability to process orders on a timely basis is not imposing any such requirement.
	TBMA: It is not apparent why this standard is necessary given the existing reporting and record keeping requirements imposed under

	Article 20 of the ISD. The recent proposal for a Market Abuse Directive, suggests that the market abuse regime will only apply in respect of instruments admitted to trading on a regulated market. Thus, the proposed standard should, at the very least, be limited to cases where the market abuse regime is capable of applying to those trading through an electronic trading system. The proposed standard suggests that its requirements would apply whenever a qualifying system provides for trading in instruments "traded on other systems", regardless of the nature of those other systems. Consequently, it is not apparent why it is necessary to adopt this standard when all member states should already have adopted requirements mandating all investment firms to report transactions and to maintain records of transactions in accordance with Article 20 of the ISD. The purpose of these transaction reporting and record keeping requirements is precisely to enable authorities to investigate cases of insider dealing and market manipulation. Thus, it is wholly unclear why additional obligations should be imposed on particular market participants merely because they trade using an electronic trading system, nor should regulators impose reporting and record keeping obligations on someone who operates an electronic trading system when similar obligations are not imposed on those engaging in equivalent business by conventional means. Likewise, it would be inappropriate to impose a requirement to maintain market monitoring facilities of the kind currently maintained by some regulated markets merely because a firm operates an electronic trading system rather than trading by conventional means, while a particular operator may choose to do this to enhance the confidence of users and to encourage use of the system, such a requirement should not be mandated. Moreover, the fact that such a requirement may be imposed on regulated markets does not justify the imposition of the same requirement on electronic trading systems, as regulated markets obtain the important benefit of regulatory endorsement not conferred on operators that choose to operate as investment firms. Additionally, imposing such a requirement tends to distort the market in the provision of trading services by imposing additional costs on particular market players that should be more equitably spread among all intermediaries through regulatory charges.
	NFMF: It is difficult to oversee all the implications of standard 8, especially regarding the more detailed requirements, i.e. in connection with market abuse.
	5. National consultations
	No response provided.
	6. Others
	No response provided.
Standard 9	***Investment firms operating a qualifying system should be able to demonstrate to the relevant 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.
Question 15. (IT system requirements)	*Comments are invited on this standard. This standard is of particular importance for systems which are integral to the broader market in an instrument. FESCO would be interested in views on whether quantitative thresholds should be set to measure the importance of a system and, if so, what these might be.*
	1. Exchanges/Reg. Markets/ Organisations
	Euronext: No specific comments.
	ISMA agrees with FESCO that systems which are 'integral to the broader market in a particular instrument' should be subject to a system integrity standard. ISMA thinks that is particularly the case, on systemic risk grounds, where the system routes executed orders directly into clearing and settlement institutions. However, as in response to earlier questions, in the case of most ATSs falling within FESCO's proposed definition, any regulatory obligations should not go beyond the requirements properly imposed as part of the prudential supervision of the firm, and in particular its risk management practices since they will exclusively be offered to professional users who are well placed to make their own judgements on these matters and who are the only ones at risk.
	Wiener Börse: clearing and settlement arrangements should be mentioned although they would not be provided by the ATS itself. The switch of an ATS from a "wholesale-only" to an "also-retail system" should be monitored.
	Interbolsa: Yes. For each instrument traded on an ATS, the quantity, the value of the trades and the number of its users as well as the access to the number of its clients. The availability of such data should be made on a monthly, quarterly and annual basis.
	Bolsa Valencia: According to question 9, the systems should have in place the proper technical arrangements.
	2. Alternative Trading Systems
	BrokerTec: If other electronic service providers are not required to demonstrate technical robustness, it is difficult to see why an ATS should be placed under this additional burden. BrokerTec would be more than happy to demonstrate its system and the contingency plans it has in place, but to require a formalised demonstration, particularly if required by authorities other than the ATS' home regulator seems to be iniquitous. In order to justify such investigation, the concern is surely the integrity of an existing market, so again the ATS must have reached a "critical mass", which in a circular way is only possible if

	the users are happy to use the system (a self fulfilling performance measure). It is a different question as to (i) how a home regulator would treat an ATS that had obviously and seriously failed to have a robust enough system and had the effect of replacing a stock exchange (it would be entirely proper to impose restrictions or penalties in such circumstances), and (ii) operators having to demonstrate the system to "relevant regulatory authorities" before being permitted to trade in the relevant market. In the first instance, there could be existing grounds under the principles of surveillance to which any firm was already subject whereas, the second creates a new layer of surveillance by foreign regulatory authorities. Some products only exist on some platforms, so may de facto be regarded as "integral" to the market, but particularly in the inter-professional markets these are usually just simplified ways for trading a structured OTC product. Systems that deal with market professionals should not be placed under any additional "qualification" burden.
	EuroMTS: the IT systems for ATSs must be robust and deliver the promised service, this is an area where the regulator can enforce the delivery of minimum standards. A minimum industry standard would be welcomed both by established providers and by new entrants to the markets. If a system is a regulated ATS then the user should be entitled to expect that the IT infrastructure is suitable for the service being proposed. The regulator can not set prescriptive standards for minimum levels in all areas but can ensure that the operator has adequate Service Level Agreements with its technology provider that cover (a) Security of data, (b) availability of system and business continuity, and (c) minimum performance levels. If these agreements are missing then the regulator must be satisfied that sufficient controls are in place.
	ITG would be quite concerned that this standard could be mis-interpreted and lead to an ineffective allocation of resources by both regulators and operators to an area generally agreed as being extremely difficult to effectively supervise. For example, ITG believes it is unreasonable for a typical crossing system to be required to have say 'site redundancy' contingency arrangements given 'hits' or executions on submissions can never be relied upon by participants anyway. While the word 'satisfactory' within the standard should cover this and similar situations ITG believes there's a significant risk that it will not. Equally, ITG thinks it's inappropriate to put in the standard a matter the standard itself acknowledges is covered by existing regulations to which investment firms are subject. In conclusion, ITG believes that the standard should be 'rolled back' to deal only with the narrow number of areas where additional regulation may be needed (e.g. integral to the market and dominant market position).
	Tradeweb broadly agrees with the principle set out in the standard and the explanatory material, and would emphasise the desirability of ensuring that all ATSs of similar profile are required to comply with

	similar technical standards to ensure the protection of investors. This should, however, be qualified in the case of markets with sophisticated participants. In institutional markets such as fixed-income markets, there is sufficient sophistication in market participants for the market for ATSs to be, to some extent, self-regulating, as sophisticated market participants are aware of their regulatory obligations to their clients and of the need to conduct diligence on the systems that they use. Tradeweb therefore believes that the application of the standard should be proportionate to the market serviced by the ATS in question.
	3. Banks/Bank Associations
	Bank of Finland: *Question 15* concerns the wording of Standard 9 and whether quantitative thresholds should be set to **measure the importance of a system**. It is clear that ATSs that are likely to have impact on systemic risk and stability of the financial markets should be well-managed and be able to facilitate monitoring of markets by authorities. However, it is most cumbersome to set strict and public thresholds given that it may produce moral hazard and that in Europe there is very little data available on the current role of the ATSs (in the securities markets at least). Admitting that the U.S. equities markets are structured in a different manner than the European markets it seems that at least some major ECNs are starting to gain such a sizeable share of the trade volumes in Nasdaq shares that they are gaining some systemic importance. In March 2001 the two largest systems namely Island and Instinet intermediated almost 35 per cent of trades in Nasdaq securities. In June 2001 the total of trade volumes of the six largest ECNs corresponded to 35,5 percent of the total dollar volumes in Nasdaq.
	BBA: This standard can only be justified if it applies to systems defined in the way suggested by the Association. The justification for applying it would be the "public good" rationale. In practice, where an ATS is already authorised by a home state regulator such risks would be dealt with, in the normal way, through the regulator's prudential supervision of the firm. The Association does not think that additional obligations, beyond normal prudential supervision, can be justified for ATSs. This is particularly true of professional only systems as professional users are well able to make their own assessment of the risks to their own institution.
	Zentraler Kreditausschus believes that there is no specific need for regulation as far as ensuring satisfactory system capability is concerned, since, in his own interest and for competitive reasons, the operator will see that his trading platform meets the required security and functionality standards. Moreover, there is no duty to contract in the case of bilateral systems. So-called “contingency arrangements” are therefore unnecessary here at any rate if other systems or platforms are available to the user for trading in the security in

	question. Because of the marketplace function they have to perform, the situation is somewhat different for securities trading systems. To ensure both investor protection and functional protection, it might be advisable for multilateral systems to supplement the existing provisions on data protection, stability and accessibility. The BSK therefore also recommends ensuring system security in the case of multilateral systems by way of guidelines relating to Section 33, paragraph 1 of the Securities Trading Act. At the same time, however, a clear separation from the requirements applying to exchanges is essential, particularly for cost reasons, in order to ensure that ATSs are given a raison d'être as low-cost trading platforms.
	Summary of German Consultation: Some participants argued that there is no specific need for regulation as far as ensuring satisfactory system capability is concerned. It was argued that the operator will – in his own interest and for competitive reasons – see that his trading platform meets the required security and functionality standards. A difference was made with regard to systems with a market place function. To ensure investor protection and functional protection, it was argued that a supplement of the existing provisions on data protection, stability and accessibility might be advisable for multilateral systems.
	Caja Madrid Bolsa: This is a very complex and wide topic that also refers to the security of the system as a whole. It might be advisable for the supervisor to count on some "external auditors" to help him in its supervisory tasks in this point.
	Banco de Sabadel: There should be quantitative means in place to evaluate the impact of an ATS on the broader market in a particular instrument.
	4. <u>Investment firms-/organizations</u>
	AFEI: This standard, too, raises the question of exactly who the "relevant regulatory authorities" are. Furthermore, investment firms are already under an obligation to have the resources necessary to provide investment services. It should in any case be emphasised that the system of interest here is not one operated by a regulated market. It is to be expected that it will not meet the same standards as a regulated market. It is designed first and foremost to meet commercial imperatives: if the quality of the service that it offers is not adequate, it will not attract users. It is normal that this aspect of things should be left to the competitive domain; if users turn to an ATS rather than a regulated market, it is because they find an advantage in doing so. It is normal that there should be a difference in terms of risk to the user (there must be a risk in going onto an ATS, whereas on a regulated market the user has no reason to question the

	security of the system), and it is not the province of regulators to oversee an aspect that falls in the competitive domain. To do so would lead to regulatory authorities labelling the quality level of the ATS and thereby placing it in the same position as a regulated market. The thinking behind the proposed standard should instead be oriented towards a principle setting forth the information an ATS ought to give users about the security procedures it has implemented.
	Barclays has the following comments: ➢ In general issues such as systems security and integrity are most appropriately dealt with by competition between operators and contract terms between operators and users. ➢ In the case of retail users, and where the systems failure might be disruptive to the market as a whole then regulatory standards might be appropriate. In any event, Barclays believes that regulators would be able to rely on their general powers to assess the enterprise as a whole on a 'fit and proper' basis. ➢ It might therefore be more proportionate to require the disclosures envisaged in Standard 9 to users where these are retail customers but not otherwise and to the regulators where there is an issue of market integrity.
	TBMA: It is difficult to see why the home state regulators should depart from a traditional analysis of the prudential risks to the firm itself arising from the operations of a system. Again, the text of this standard does not clearly identify which authorities are the "relevant regulatory authorities" responsible for supervising compliance with the proposed requirements in a cross-border context. However, Annex A to the FESCO paper suggests that the proposed requirements are linked to the prudential requirements under Article 10 of the ISD. These are, of course, home state matters. TBMA believes that this is an appropriate allocation of responsibility in this regard. It would be duplicative and unduly burdensome if a firm had to demonstrate the adequacy of its systems and controls to regulators in countries in which its branches are located just because a particular system is operated through a branch. The home state regulator should be able to take account of any wider issues presented by a firm's operation of a proposed system, even if that system is primarily operated from a branch located in another member state. This is the case even though the primary focus of the proposed standard is not just the possible adverse impact of a systems failure on the firm itself - which would be the traditional focus of prudential standards. Clearly, any material systems failure might threaten the continued existence of the operator and this is something that would normally be addressed as part of a prudential review. However, the standard proposes a wider review which focuses on the possible

	adverse impact of a failure on users and the wider market. It is important that FESCO's standard makes clear when it is necessary to conduct such a wider review. TBMA agrees that it is conceivable that an electronic system might become so integral to the functioning of a significant market (i.e. a "core system") that a broader review should be applied because of the systemic risks that might result from a systems failure - even though the failure does not itself threaten the continued existence of the operator. However, TBMA believes that, currently, this is unlikely to be the case with respect to any electronic trading system operating in Europe that is not licensed as a regulated market. In particular, the temporary or permanent failure of those electronic trading systems operating in the fixed income markets would not leave market participants with no alternative means of trading and seems unlikely to cause significant disruption. FESCO should indicate whether or not it agrees with this assessment. In the absence of such circumstances, it is difficult to see why the home state regulator should depart from a traditional analysis of the prudential risks to the firm itself arising from the operation of a system, at least where the users of the system are professional investors. Therefore, to this extent, TBMA considers that the proposed standard overstates the need for additional intervention by regulators in these markets. As already indicated, TBMA does not consider that it would be appropriate to use quantitative thresholds to measure whether a system has become integral to the operation of a significant market.
	5. National consultations
	No response provided.
	6. Others
	No response provided.
Standard 10	***Investment firms operating qualifying systems should ensure that there is clarity of obligations and responsibilities for the settlement of transactions.***
Question 16. Settlements	*FESCO would be particularly interested to receive feedback as to what the respective responsibilities of the operator and user should be, particularly when retail users are involved.*
	1. Exchanges/Reg. Markets/ Organisations
	Euronext: This standard should also deal with clear obligations and responsibilities for clearing of transactions and not only settlement of transactions.
	ISMA : It is to be expected that professional users will take great care in this area, as counterparty risk, and its various elements, has become an issue of primary importance in recent years. The ISMA believes therefore that regulatory involvement should be limited to protecting the interests of retail investors. In the context of this standard ISMA awaits with interest

	FESCO's conclusions on its conduct of business proposals concerning firms accepting orders only when they have an assurance that the investor can meet the obligation he wishes to enter into, and to what extent this will limit, for example, the provision of retail-focused, execution-only ATSs to banks dealing for their banking customers.
	Wiener Börse: arrangements should also be in place for clearing, not only for settlement.
	Interbolsa: Each firm operating an ATS must ensure that the users have a perfect knowledge of their rights, obligations and responsibilities that may vary from system to system. Once again, reference must also be made to the clearing of operations.
	Bolsa Valencia: The clearing and settlement of the transactions is very important and should be taken into account when regulating qualifying systems, and thus, standard 10 is suitable.
	2 . Alternative Trading Systems
	BrokerTec: For professional markets there should be no further requirement than the explanation of any particular settlement or operational procedure (including communications circuits and instruction formats).
	ITG has no comment on this proposal other than to say they would regard it as being covered by existing investment firm responsibilities to their clients.
	EuroMTS: participants grant power of attorney for the system to generate settlement instruction according to pre-agreed standard settlement instructions. This is a much higher level of support than most systems could guarantee and reduces the amount of post-trade errors as a result.
	Tradeweb does not consider that it would be appropriate to impose any particular standards for clearance and/or settlement on the underlying terms of business between dealers and users on the system other than to oblige them to comply with their obligations under their terms of business: these are an individual matter for dealers and their customers.
	3. <u>Banks/Bank Associations</u>
	Caja Madrid Bolsa: The operator should guarantee the operations specially those of the retail users, using the mechanisms previously authorised by the relevant authorities.
	Banco de Sabadel: The operator is responsible for the correct price formation process, the price transparency, the general management of the system, etc.

	The users are responsible for fulfilling the agreements set up in their contract with the operator.
	4. Investment firms-/organizations
	AFEI: This standard should not be put forward on a free-standing basis. It is part of the terms and conditions for use of the system, which have already been addressed in other standards.
	Barclays has the following comments: ➢ Except in the case of retail users, these issues should be dealt with by contract. ➢ In the case of professionals or intermediate users, then public policy requires them to be responsible for the protection of their own interests, where this is possible, which in this instance it clearly is.
	TBMA: This standard should not, in principle, apply to relationships with professional investors. Professional investors that are users of electronic trading systems need to evaluate for themselves whether the system meets their trading needs. Regulators should not seek to interpose themselves into these relationships by mandating particular types of disclosures to professional investors that are considering using a particular electronic trading system. ***Access to trading*** TBMA welcomes the fact that the consultative paper does not seek to impose requirements on firms operating qualifying systems to admit users. TBMA agrees that this is an issue, which is best addressed by competition law authorities in accordance with established competition rules.
	5. National consultations
	No response provided.
	6. Consumer/Investor Organisations
	Euroshareholders: This item is very important for the private investor. No ATS should be authorised without a clear and guaranteed system for clearing and settlement of the transactions. The responsibility - without division - of the system operator and all intermediaries should be clearly defined. An interesting point is whether there is an arbitrage system or not, whether there is a compensation fund or not (all this to be announced clearly).
	7. Others
	No response provided.

Question 17. (Costs and benefits)	*Comments are invited on the methodology set out above. Further observations and any quantitative information on potential compliance costs of the proposed standards would be particularly welcome.*
	1. Exchanges/Reg. Markets/ Organisations
	ISMA : thinks it is unfortunate that FESCO's proposals have got to this stage without any attempt having been made to quantify costs and benefits since ISMA understands that the industry will have no further opportunity to comment on the proposals before they are finalised in December of this year. ISMA recognises, however, that in some member states there will be a further opportunity when the local regulator consults on domestic implementation. However, ISMA also recognises that by that time, most FESCO members will be unwilling, naturally, to diverge significantly from the agreed position whatever mismatches in this area the responses to those consultations might demonstrate. Clearly, as FESCO recognises, much will depend on sensitive implementation of the standards by its members. While a key element, as FESCO notes, will be differentiating 'between systems on the basis of the risks they pose' that is not the only element. If FESCO is unable to secure a consensus among its members that implementation of the standards should be the responsibility of the country of origin regulator then costs to ATS providers could vary by a multiple (currently) of up to17 depending on the extent to which members choose to implement a standard on 'incoming' ATSs and the extent to which a particular provider seeks to operate in multiple jurisdictions. Finally, it is not clear that competition will be enhanced overall. As observed above, differing interpretation of some standards, such as Standard 6 on transparency, could prevent users in some jurisdictions from access to a preferred trading system. Some users will prefer to revert to non-automated or semi-automated dealing mechanisms. If ATS providers (but not conventional brokers or dealers) are required to develop multiple bilateral arrangements with regulators across Europe (Standard 6) to facilitate the pursuit of market abusers, firms contemplating building and offering more efficient trading mechanisms may choose to delay until a more genuinely level playing field for the provision of trading services has been achieved.
	Interbolsa: The *Interbolsa* considers that with the application of the standards, there will be a balance between the costs and benefits for the ATS'. However, it does not comment on the proposed methodology due to the fact that the available elements do not allow for a quantification of the costs.
	Bolsa Valencia: In general, they agree with the methodology of costs and benefits set out by FESCO.
	2. Alternative Trading Systems
	ITG notes the Annex acknowledges that the 'costs, should not, in general, be significant, provided that the standards differentiate

	between systems on the basis of the risks they pose'. ITG agrees completely with the importance of this proviso and wonder could FESCO put in place a post implementation review date or some other mechanism for regulators, operators and others to review and comment upon the effectiveness of the implementation / operation of the standards in practice. With regard to the efficiency of competition, as alluded to earlier, ITG feels the standard has the potential to distort competition by regulating automated but not non-automated ways of conducting the same activity.
	3. <u>Banks/Bank Associations</u>
	BBA: Paragraph 12 of the Consultation paper asserts that the proposed standards are proportionate to the potential risks. This cannot be true for two reasons: ➢ no quantification of the costs of compliance with the standards has been undertaken; ➢ the risks are described as potential – no assertion is made that they are real and no estimate of the costs associated with them (and therefore the benefit to be gained if they are avoided) has been attempted. The Association would contend therefore that FESCO is acting in pursuit of the precautionary principle rather than on a proportional basis. This is contrary to the general thrust of EU legislation/regulation and should only be adopted as an approach in the most serious of cases – certainly not in financial markets. Paragraph 30 of the Consultation document says "the wider costs, should not, in general, be significant, provided that the standards are implemented in a way that differentiates between systems on the basis of the risks they pose." The BBA believes that this is an absolutely key proviso and that unless ATSs aimed at the professional and intermediate market are excluded from the majority of the standards, then the costs incurred will be significant and out of proportion to any benefit which might accrue.
	4. <u>Investment firms-/organizations</u>
	Barclays: Paragraph 12 of the Consultation paper asserts that the proposed standards are proportionate to the potential risks. This cannot be true for two reasons: ➢ no quantification of the costs of compliance with the standards has been undertaken; ➢ the risks are described as potential – no assertion is made that they are real and no estimate of the costs associated with them (and therefore the benefit to be gained if they are avoided) has been attempted. Barclays contends that FESCO is acting in pursuit of the

	precautionary principle rather than on a proportional basis. This is contrary to the general thrust of EU legislation/regulation and should only be adopted as an approach in the most serious of cases – certainly not in financial markets.
	EAMA is concerned that there is no explicit recognition that one of the costs of excessive regulation of ATS may be a significant diminution in liquidity in some instruments. This factor should be taken into account when assessing the costs and benefits of the proposed standards.
	5. National consultations
	No response provided.
	6. Others
	No response provided.