

Organised trading facilities (OTFs)

Chapter 5A

Organised trading facilities (OTFs)



5A.1 Application

Who and what?

5A.1.1

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This chapter applies to:

- (1) a *UK domestic firm* which operates an *OTF* from an establishment in the *United Kingdom* or elsewhere; or
- (2) an *overseas firm* which operates an *OTF* from an establishment in the *United Kingdom*.

5A.1.2

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In addition:

- (1) In accordance with paragraph 15(9) of the Schedule to the *Recognition Requirement Regulations* and **■ REC 2.16A.1GR**, **■ MAR 5A.3.9R** applies to a *UK RIE* as though it was an *investment firm*.
- (2) **■ GEN 2.2.22AR** applies to ensure that a *third country investment firm* should not be treated in a more favourable way than an *EEA firm*.



5A.2 Purpose

- 5A.2.1 **G** The purpose of this chapter is to implement the provisions of *MiFID* relating to *firms* operating *OTFs*, specifically articles 18, 20, 31, 32, 48, 49 and 50 of *MiFID*.
- 5A.2.2 **G** ■ MAR 5A.3.9R also sets out how the obligations of an *investment firm* under articles 16, 24, 25, 27 and 28 (as transposed in the *FCA Handbook*) apply to a *firm* operating an *OTF* in respect of that operation.
- 5A.2.3 **G** This chapter does not apply to bilateral systems, which are excluded from the *OTF* definition.

5A.3 Specific requirements for OTFs

Executing orders

5A.3.1

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A *firm* must:

- (1) execute orders on a discretionary basis in accordance with
■ MAR 5A.3.2R;
- (2) unless permitted in ■ MAR 5A.3.5R, not execute any *client* orders against its proprietary capital or the proprietary capital of any entity that is part of the same group or legal person as the *firm*; and
- (3) ensure that the operation of an *OTF* and of a *systematic internaliser* does not take place within the same legal entity, and that the *OTF* does not connect with another *OTF* or with a *systematic internaliser* in a way which enables orders in the different *OTFs* or *systematic internaliser* to interact.

[Note: article 20(1) to (4) and 20(6) of *MiFID*]

5A.3.2

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The discretion which the *firm* must exercise in executing a *client* order must be either, or both, of the following:

- (1) the first discretion is whether to place or retract an order on the *OTF*;
- (2) the second discretion is whether to match a specific *client* order with other orders available on the *OTF* at a given time, provided the exercise of such discretion is in compliance with specific instructions received from the *client* and in accordance with the *firm's* obligations under article 27 of *MiFID*.

[Note: article 20(6) of *MiFID*]

5A.3.3

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Where the *OTF* crosses *client* orders, the *firm* may decide if, when and how much of two or more orders it wants to match. In addition, subject to the requirements of this section, the *firm* may facilitate negotiation between *clients* so as to bring together two or more potentially comparable trading interests in a transaction.

[Note: article 20(6) of *MiFID*]

5A.3.4 **G** ■ MAR 5A.3 does not prevent a *firm* from engaging another *investment firm* to carry out market making on an independent basis on an *OTF* operated by it provided the *investment firm* does not have *close links* with the *firm*.

[Note: article 20(5) of *MiFID*]

Proprietary trading

5A.3.5 **R** A *firm* must not engage in:

- (1) *matched principal trading* on an *OTF* operated by it except in bonds, *structured finance products*, *emission allowances* and derivatives which have not been declared subject to the clearing obligation in accordance with article 5 of *EMIR*, and where the *client* has consented; or
- (2) *dealing on own account* on an *OTF* operated by it, excluding *matched principal trading*, except in *sovereign debt instruments* for which there is not a liquid market.

[Note: article 20(2) and (3) of *MiFID*]

5A.3.6 **R** For the purposes of ■ MAR 5A.3.5R(2), a “liquid market” means a market for a *financial instrument* or a class of *financial instruments*, where there are ready and willing buyers and sellers on a continuous basis, assessed in accordance with the following criteria, taking into consideration the specific market structures of the particular *financial instrument* or of the particular class of *financial instruments*:

- (1) the average frequency and size of transactions over a range of market conditions, having regard to the nature and life cycle of products within the class of *financial instrument*;
- (2) the number and type of market participants, including the ratio of market participants to traded instruments in a particular product; and
- (3) the average size of spreads, where available.

[Note: article 4(1)(25) of *MiFID*]

5A.3.7 **R** A *firm* engaging in *matched principal trading* in accordance with ■ MAR 5A.3.5R(1) must establish arrangements to ensure compliance with the definition of *matched principal trading*.

[Note: article 20(1) and (7) of *MiFID*]

5A.3.8 **G** *Matched principal trading* does not exclude the possibility of settlement risk, and, accordingly, *firms* should take appropriate steps to minimise this risk. For *guidance* relating to the treatment of *matched principal trading* for the purposes of *IFPRU* prudential categorisation, see ■ PERG 13 Q61 and Q64.

Other MiFID obligations

5A.3.9 **R** A *firm* must comply with the obligations under the following provisions of *MiFID*, in the course of operating an *OTF*:

- (1) articles 16(2), 16(3) (first subparagraph), 16(4), 16(5), 16(6), 16(7), 16(8), 16(9), and 16(10);
- (2) articles 24(1), (3), (4), (5), (9), (10) and (11);
- (3) articles 25(3) (except to the extent that article 25(4) applies), 25(5), and 25(6) (to the extent applicable);
- (4) article 27; and
- (5) article 28.

[**Note:** article 20(8) of *MiFID*. The above *MiFID* provisions are transposed as follows in the *FCA Handbook*:

- (1) ■ SYSC 6.1.1, ■ SYSC 10.1.7, ■ SYSC 4.1.6, ■ SYSC 8.1.1, ■ SYSC 4.1.1(1), ■ SYSC 4.1.1(3), ■ SYSC 9.1.1A, ■ SYSC 10A, ■ CASS 6.2.1 and ■ CASS 7.12.1;
- (2) ■ COBS 2.1.1, ■ COBS 4.2.1, ■ COBS 4.3.1, ■ COBS 2.2A.2, ■ COBS 2.2A.3, ■ COBS 2.3A.5, ■ SYSC 19F.1.2 and ■ COBS 6.1ZA.16;
- (3) ■ COBS 10A.2.1, ■ COBS 10A.2.2, ■ COBS 10A.3.1, ■ COBS 10A.3.2, ■ COBS 10A.4.1, ■ COBS 8A, ■ COBS 16A.2.1 and ■ COBS 9A.3.2;
- (4) ■ COBS 11.2A; and
- (5) ■ COBS 11.3.]

Reporting to the FCA

5A.3.10

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A *firm* must:

- (1) in respect of an *OTF* operated by it, or such a facility it proposes to operate, provide to the *FCA* a detailed explanation of:
 - (a) why the *OTF* does not correspond to, and cannot operate as, an *MTF*, a *regulated market* or a *systematic internaliser*;
 - (b) how discretion will be exercised in executing *client orders*; and
 - (c) its use of *matched principal trading*; and
- (2) supply the information in (1) to the *FCA* in writing, by electronic mail to an address for the usual supervisory contact of the *firm* at the *FCA*, and obtain an electronic confirmation of receipt.

[**Note:** article 20(7) of *MiFID*]

5A.3.11

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A *person operating an organised trading facility* cannot also provide the service of a *systematic internaliser*, irrespective of whether the *systematic internaliser* trades different *financial instruments* or types of *financial instruments* to those traded on the *OTF*.



5A.4 Trading process requirements

Rules, procedures and arrangements

5A.4.1

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A *firm* must have:

- (1) transparent rules and procedures for fair and orderly trading;

[Note: article 18(1) of *MiFID*]

- (2) objective criteria for the efficient execution of orders;

[Note: article 18(1) of *MiFID*]

- (3) arrangements for the sound management of the technical operations of the facility, including the establishment of effective contingency arrangements to cope with the risks of systems disruption;

[Note: article 18(1) of *MiFID*]

- (4) transparent rules regarding the criteria for determining the *financial instruments* that can be traded under its systems;

[Note: subparagraph (1) of article 18(2) of *MiFID*]

- (5) arrangements to provide, or be satisfied that there is access to, sufficient publicly available information to enable its users to form an investment judgement, taking into account both the nature of the users and the types of instrument traded;

[Note: subparagraph (2) of article 18(2) of *MiFID*]

- (6) transparent and non-discriminatory rules, based on objective criteria, governing access to its facility and which must be published, maintained and implemented; and

[Note: article 18(3) of *MiFID*]

- (7) (as between the interests of the *OTF*, its owners, or the *firm* and those of the members and participants or users in the sound functioning of the *trading venue*) arrangements to identify clearly and to manage any conflict with adverse consequences for:

- (a) the operation of the *trading venue* for the members and participants or users; or

- (b) the members and participants or users otherwise.

[Note: article 18(4) of *MiFID*]

5A.4.2

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Functioning of an OTF

A *firm* must:

- (1) ensure the *OTF* has at least three materially active members or users who each have the opportunity to interact with all the others in respect of price formation;

[Note: article 18(7) of *MiFID*]

- (2) provide the following to the *FCA*:
 - (a) a detailed description of the functioning of the *OTF*, including any links to or participation by a *regulated market*, an *MTF* or *OTF* or *systematic internaliser* owned by the same *firm*; and
 - (b) a list of its members, participants and users; and

[Note: article 18(10) of *MiFID* and *MiFID ITS 19* with regard to the content and format of the description of the functioning of *MTFs* and *OTFs*]

- (3) make available data relating to the quality of execution of transactions on that venue, including details about price, costs, speed and likelihood of execution for individual *financial instruments* to the public in the following manner:
 - (a) at least on an annual basis; and
 - (b) without any charges.

[Note: article 27(3) of *MiFID*]

5A.4.3

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Transferable securities traded without issuer consent

Where a *transferable security*, which has been *admitted to trading* on a *regulated market*, is also traded on an *OTF* without the consent of the *issuer*, the *firm* operating the *OTF* must not make the *issuer* subject to any obligation relating to initial, ongoing or ad hoc financial disclosure with regard to that *OTF*.

[Note: article 18(8) of *MiFID*]



5A.5 Systems and controls for algorithmic trading

Systems and controls

5A.5.1 **R** A *firm* must ensure that the systems and controls, including procedures and arrangements, used in the performance of its activities are adequate, effective and appropriate for the scale and nature of its business.

5A.5.2 **R** ■ MAR 5A.5.1R applies in particular to systems and controls concerning:

- (1) the resilience of the *firm's* trading systems;
- (2) its capacity to deal with peak order and message volumes;
- (3) the ability to ensure orderly trading under conditions of severe market stress;
- (4) the effectiveness of business continuity arrangements to ensure the continuity of the *OTF's* services if there is any failure of its trading systems, including the testing of the *OTF's* systems and controls;
- (5) the ability to reject orders that exceed predetermined volume and price thresholds or which are clearly erroneous;
- (6) the ability to ensure that *algorithmic trading* systems cannot create or contribute to disorderly trading conditions on the *trading venue*;
- (7) the ability to ensure that any disorderly trading conditions which do arise from the use of *algorithmic trading* systems are capable of being managed, including systems to limit the ratio of unexecuted orders to *transactions* that may be entered into the *OTF's* trading system by a member or participant;
- (8) the ability to ensure that the flow of orders is capable of being slowed down if there is a risk of system capacity being reached;
- (9) the ability to limit and enforce the minimum tick size which may be executed on the *OTF*; and
- (10) the requirement for members and participants to carry out appropriate testing of algorithms, including providing environments to facilitate that testing.

[**Note:** article 48(1), (4) and (6) of *MiFID*, *MiFID RTS 7*, *MiFID RTS 9*, and *MiFID RTS 11*]

Market making agreements

5A.5.3

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A *firm* must:

- (1) have written agreements with all *investment firms* pursuing a *market making strategy* on *trading venues* operated by it (market making agreements);
- (2) have schemes, appropriate to the nature and scale of a *trading venue*, to ensure that a sufficient number of *investment firms* enter into market making agreements which require them to post firm quotes at competitive prices with the result of providing liquidity to the market on a regular and predictable basis;
- (3) monitor and enforce compliance with the market making agreements;
- (4) inform the *FCA* of the content of its market making agreements; and
- (5) provide the *FCA* with any information it requests which the *FCA* reasonably requires to be satisfied that the market making agreements comply with this *rule*.

[Note: article 48(2) and (3) of *MiFID* and *MiFID RTS 8*]

5A.5.4

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A market making agreement in ■ MAR 5A.5.3R(1) must specify:

- (1) the obligations of the *investment firm* in relation to the provision of liquidity;
- (2) where applicable, any obligations arising, or rights accruing, from the participation in a liquidity scheme mentioned in ■ MAR 5A.5.3R(2); and
- (3) any incentives in terms of rebates or otherwise offered by the *firm* to the *investment firm* in order for it to provide liquidity to the *OTF* on a regular and predictable basis and, where applicable, any other rights accruing to the *investment firm* as a result of participation in the liquidity scheme.

[Note: article 48(3) of *MiFID* and *MiFID RTS 8*]

Measures to prevent disorderly markets

5A.5.5

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A *firm* must have the ability to:

- (1) temporarily halt or constrain trading on the *OTF* if there is a significant price movement in a *financial instrument* on the *OTF* or a related *trading venue* during a short period; and
- (2) in exceptional cases, cancel, vary, or correct, any *transaction*.

[Note: article 48(5) of *MiFID*]

5A.5.6

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For the purposes of ■ MAR 5A.5.5R, and to avoid significant disruptions to the orderliness of trading, a *firm* must calibrate the parameters for halting trading in a way which takes into account the following:

- (1) the liquidity of different asset classes and subclasses;
- (2) the nature of the *trading venue* market model; and
- (3) the types of users.

[Note: article 48(5) of *MiFID*]

5A.5.7 **R** The *firm* must report the parameters mentioned in **■ MAR 5A.5.6R** to the *FCA* in writing, by electronic mail to an address for the usual supervisory contact of the *firm* at the *FCA*, and obtain an electronic confirmation of receipt.

[Note: article 48(5) of *MiFID*]

5A.5.8 **R** A *firm* must have systems and procedures to notify the *FCA* if:

- (1) an *OTF* operated by it is material in terms of the liquidity of the trading of a *financial instrument* in the *EEA*; and
- (2) trading is halted in that instrument.

[Note: article 48(5) of *MiFID*]

Direct electronic access.....

5A.5.9 **R** A *firm* which permits *direct electronic access* to an *OTF* it operates must:

- (1) not permit members or participants of the *OTF* to provide such services unless they are:
 - (a) *investment firms* authorised under *MiFID*; or
 - (b) *CRD credit institutions*; or
 - (c) third country firms providing the *direct electronic access* in the course of exercising rights under article 46.1 of *MiFIR*; or
 - (d) third country firms providing the *direct electronic access* in the course of exercising rights under article 47.3 of *MiFIR*; or
 - (e) third country firms providing the *direct electronic access* in accordance with the exclusion in article 72 of the *RAO*; or
 - (f) third country firms which do not come within **■ MAR 5A.5.9R(1)(d)** to (f) but are otherwise permitted to provide the *direct electronic access* under the *Act*; or
 - (g) *firms* that come within article 2.1(a), (e), (i), or (j) of *MiFID* and have a *Part 4A permission* relating to *investment services or activities*;
- (2) set and apply criteria for the suitability of *persons* to whom *direct electronic access* services may be provided;
- (3) ensure that the member or participant of the *OTF* retains responsibility for adherence to the requirements of *MiFID* in respect of orders and trades executed using the *direct electronic access* service;

- (4) set standards for risk controls and thresholds on trading through *direct electronic access*;
- (5) be able to distinguish and if necessary stop orders or trading on that trading venue by a person using *direct electronic access* separately from:
 - (a) other orders; and
 - (b) trading by the member or participant providing the *direct electronic access*; and
- (6) have arrangements to suspend or terminate the provision of *direct electronic access* on that market by a member or participant in the case of any non-compliance with this *rule*.

[Note: article 48(7) of *MiFID*]

Co-location

5A.5.10

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Where a *firm* permits co-location in relation to the *OTF*, its rules on co-location services must be transparent, fair and non-discriminatory.

[Note: article 48(8) of *MiFID* and *MiFID RTS 10*]

Fee structures

5A.5.11

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A *firm's* fee structure, for all fees it charges and rebates it grants in relation to the *OTF*, must:

- (1) be transparent, fair and non-discriminatory;
- (2) not create incentives to place, modify or cancel orders, or execute *transactions*, in a way which contributes to disorderly trading or *market abuse*; and
- (3) impose market making obligations in individual *financial instruments* or suitable baskets of *financial instruments* for any rebates that are granted.

[Note: article 48(9) of *MiFID* and *MiFID RTS 10*]

5A.5.12

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Nothing in **■** MAR 5A.5.11R prevents a *firm*:

- (1) adjusting its fees for cancelled orders according to the length of time for which the order was maintained;
- (2) calibrating its fees to each *financial instrument* to which they apply;
- (3) imposing a higher fee:
 - (a) for placing an order which is cancelled than an order which is executed;
 - (b) on participants placing a high ratio of cancelled orders to executed orders; and
 - (c) on a *person* operating a *high-frequency algorithmic trading technique*,

in order to reflect the additional burden on system capacity.

[Note: article 48(9) of *MiFID*]

Flagging orders, tick sizes and clock synchronization

5A.5.13 **R** A *firm* must require members and participants of an *OTF* operated by it to flag orders generated by *algorithmic trading* in order for the *firm* to be able to identify the following:

- (1) different algorithms used for the creation of orders; and
- (2) the *persons* initiating those orders.

[Note: article 48(10) of *MiFID*]

5A.5.14 **R** The *firm* must adopt tick size regimes for *financial instruments* as required by a regulatory technical standard made under article 49.3 or 49.4 of *MiFID*.

[Note: article 49 of *MiFID* and *MiFID RTS 11*]

5A.5.15 **R** The tick size regime referred to in **MAR 5A.5.14R** must:

- (1) be calibrated to reflect the liquidity profile of the *financial instrument* in different markets and the average bid-ask spread, taking into account the desirability of enabling reasonably stable prices without unduly constraining further narrowing of spreads; and
- (2) adapt the tick size for each *financial instrument* appropriately.

[Note: article 49 of *MiFID* and *MiFID RTS 11*]

5A.5.16 **G** Nothing in **MAR 5A.5.14R** or **MAR 5A.5.15R** requires a *firm* to act inconsistently with any regulatory technical standards made under article 49.3 or 49.4 of *MiFID*.

[Note: article 49 of *MiFID*]

5A.5.17 **R** The *firm* must synchronise the business clocks it uses to record the date and time of any reportable event.

[Note: article 50 of *MiFID* and *MiFID RTS 25*]

5A.5.18 **G** For the purpose of **MAR 5A.5.17R**, the regulatory technical standards made under article 50 of *MiFID* provide further requirements.



5A.6 Finalisation of transactions

5A.6.1

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A firm must:

- (1) clearly inform its users of their respective responsibilities for the settlement of transactions executed in its *OTF*; and
- (2) have in place the arrangements necessary to facilitate the efficient settlement of the transactions concluded under its systems.

[**Note:** article 18(6) of *MiFID*]

[**Note:** in relation to derivative transactions, *MiFID RTS 26* contains requirements on the systems for clearing of such transactions]



5A.7 Monitoring compliance with the rules of the OTF

5A.7.1

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A *firm* must:

- (1) have effective arrangements and procedures relevant to its *OTF* for the regular monitoring of the compliance by its users with its rules; and
- (2) monitor the transactions undertaken by its users under its systems in order to identify breaches of those rules, disorderly trading conditions, system disruptions in relation to a *financial instrument*, or conduct that may involve *market abuse*.

[**Note:** article 31(1) of *MiFID*]



5A.8 Reporting requirements

5A.8.1

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A *firm* must

- (1) report to the *FCA* any:
 - (a) significant breaches of the *firm's* rules;
 - (b) disorderly trading conditions;
 - (c) conduct that may involve *market abuse*; and
 - (d) system disruptions in relation to a *financial instrument*;
- (2) supply the information required under this *rule* without delay to the *FCA* and any other authority competent for the investigation and prosecution of *market abuse*; and
- (3) provide full assistance to the *FCA*, and any other authority competent for the investigation and prosecution of market abuse, in its investigation and prosecution of *market abuse* occurring on or through the *firm's* systems.

[**Note:** article 31(2) of *MiFID*, articles 81 and 82 of the *MiFID Org Regulation*, *MiFID RTS 18* and *MiFID ITS 2*]



5A.9 Suspension and removal of financial instruments

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5A.9.1

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A firm must:

not exercise any power under its rules to suspend or remove from trading any *financial instrument* which no longer complies with its rules, where such a step would be likely to cause significant damage to the interest of investors or the orderly functioning of the *trading venue*;

where it does suspend or remove from trading a *financial instrument*, also suspend or remove derivatives that relate or are referenced to that *financial instrument*, where necessary to support the objectives of the suspension or removal of the underlying; and

make public any decision in (2) and notify the FCA of it.

[Note: article 32 of *MiFID*, article 80 of the *MiFID Org Regulation* and *MiFID RTS 18*]



5A.10 Pre-trade transparency requirements for non-equity instruments: form of waiver

5A.10.1 **D** A *firm* that makes an application to the *FCA* for a waiver in accordance with article 9 of *MiFIR* (in relation to pre-trade transparency for non-equity instruments) must make it in the form set out in ■ **MAR 5A Annex 1D**.
[Note: article 9 of *MiFIR* and *MiFID RTS 2*]



5A.11 Post-trade transparency requirements for non-equity instruments: form of deferral

5A.11.1 **D** A *firm* intending to apply to the *FCA* for deferral in accordance with article 11 of *MiFIR* (in relation to post-trade transparency for non-equity instruments) must apply in writing to the *FCA*.

[**Note:** article 11 of *MiFIR* and *MiFID RTS 2*]

5A.11.2 **G** A *firm* should have regard to the urgency and significance of a matter and, if appropriate, should also notify its usual supervisory contact at the *FCA* by telephone by other prompt means of communication, before submitting written application. Oral notifications should be given directly to the *firm's* usual supervisory contact at the *FCA*. An oral notification left with another person or on a voicemail or other automatic messaging service is unlikely to have been given appropriately.

Form in relation to pre-trade transparency

[Editor's note: The form can be found at this address:<https://www.fca.org.uk/publication/forms/mifid-transparency-waiver-form.doc>]

