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## **Summary of the Guidelines on systems and controls in an automated trading environment, for Trading Platforms and Investment Firms (CYSEC GD-IF-005)**

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### *Introduction and purpose*

Within the financial market, where an order under execution will probably be dealt by several investment firms prior to its completion, this guideline outlines the organisational requirements and allocates responsibilities to the investment firms in order to ensure best service and execution for the client. In essence, the guideline rests the burden of systems and controls equally and unilaterally on all investment firms involved especially those providing reception, transmission and execution. At the same time, the guideline rests the responsibility for sponsored access with the CIF sponsoring the participant.

The Cyprus Securities and Exchange Commission (CYSEC) has issued guidelines on Systems and Controls that regulated entities should have in place to comply with the current Law. The guidelines apply to a wide number of participants in the financial industry including regulated entities such as Trading Platforms, Investment Firms, Direct Market Access and Sponsored Access clients as well as software and services providers to whom IFs may outsource services.

The directive focuses on the organizational requirements of each specific entity mentioned above and provides the general governing guideline and a number of supporting guidelines leading to fulfillment of the general guideline. Regulated entities include Trading Platforms (TP) of Regulated Markets (RM) and Multilateral Platform Facilities (MTF), Investment Firms (IF – regulated in Cyprus or in another EEA state) and users having Direct Market Access (DMA) or Sponsored Access (SA) either through the trading platform's or the investment firm's Electronic Trading Systems (ETS). The guideline used the wording "must" and "should" to denote the level of obligation to apply the guideline and at the same time stresses the concept of proportionality on the "usefulness" of the applied systems and controls. The guidelines are based on the three major investment laws enacted in Cyprus that were transposed from relevant EU Directives, namely:

- Law 144 (I)/2007 on the Provision of Investment Services, the exercise of investment activities, the operation of regulated markets and other related matters
- Directive DI144-2007-01 of 2012 of CYSEC on the authorization and operating conditions of the IF
- Law 116(I)/2005 on Insider Dealing Market and Manipulation (Market abuse) Law

### *Definitions*

- CYSEC – Cyprus Security and Exchange Commission
- CIF – Cyprus registered Investment Firm
- TP – Trading Platform – a regulated platform where buyers and sellers meet to trade such as a RM or MTF
- RM – Regulated market (e.g. exchange)

- MTF – (Multilateral Trading Facility) A regulated facility (usually offered by large banks/brokers) enabling buyers and sellers to trade.
- STR – Suspicious Trading Report – a report submitted to CYSEC on suspicion of market abuse
- ETS – Electronic Trading System – IT systems for the purpose of trading, installed at the TP, CIF, DMA/SA client.
- DMA – Direct Market Access - arrangements through which a CIF permits clients to transmit orders to the CIF's internal ETS for automatic onward transmission under the CIF's trading id to a TP.
- SA – (Sponsored Access) arrangements through which a CIF permits clients to transmit orders without going through its ETS under the CIF's trading id (MPID).
- M/P/U – stands for Member/Participant/User

*Organizational requirements for TPs' ETS*

***The general guideline dictates that the ETS must comply with law and EU legislation taking into account technological advancements, trends and technology used by members.***

Supporting guidelines detail requirements for Governance. ETS should be procured, developed and monitor through formalized governance and decision making processes considering commercial, technical, risk and compliance matters.

Other factors to consider are Capacity and Resilience of the ETS, Business Continuity Planning (BCP), formalized testing procedures (unit, system, user acceptance and sign off procedures). On the operation side, Real time monitoring and continuous review, security (both physical and electronic) must be applied. Furthermore, well trained staff on both compliance and the use and operation of the ETS is essential as well as detailed record keeping of up to 5 years while having the responsibility to submit to CYSEC any STR when it crystallises.

*Organizational requirements for CIFs' ETS*

The general guideline and supporting guidelines are very similar to that of a TP. However, the proportionality concept applies in systems and controls. At the same time, this entails that same systems and controls are expected to be applied by the CIF and be able to report to CYSEC.

*Organizational requirements for TP to promote fair and orderly trading*

***The general guideline entails that the rules and procedures applied must be appropriate to the nature and scale of trading on those markets including types of members, participants and users and their trading strategies.***

The supporting guidelines require that the TP performs adequate Due Diligence and have the systems and controls to monitor against the rules of the platform and manage risk. Apply pre/post controls concerning minimum requirements, prevention of unauthorized access to ETS and filtering controls for order price and quantity. These are again without prejudice to members controls.

Furthermore, the TP should have standards covering knowledge of persons and users that will be using order entry, ability to prevent access of a member or cancel or amend a transaction and take measures to cope with excessive flooding of the order book by applying limits per participant. The TP should prevent breach of capacity limits and take measures to constrain or halt trading

through volatility interruptions, automatic rejection of orders outside set volume and price thresholds. Such a framework should be communicated to M/P/Us.

Furthermore the TP should monitor compliance with the framework by obtaining information from the M/P/Us. The TP should monitor real time for possible signs of disorderly trading and to this effect should employ knowledgeable staff that are accessible by CYSEC and authorized to take remedial action to protect fair and orderly trading. The 5 year record keeping rule again applies while there is the obligation to report to CYSEC and significant risk that may affect fair and orderly trading once it crystallizes.

*Organizational requirements for CIFs to promote fair and orderly trading*

Just as with the TPs, the CIF is obliged to apply similar systems and controls. In addition CIF follow the CEBS guidelines on management of operational risk and also make sure that its systems meet minimum IT compatibility with the ETS of the TP

*Organizational requirements for the TP to prevent market abuse*

***The general guideline entails that the TP should apply effective procedures to identify conduct that involves market abuse such as ping orders, quote stuffing, momentum ignition, layering and spoofing.***

The supporting guidelines require the TP to have knowledgeable staff to identify such behaviour, monitor systems real time and submit STRs to CYSEC. The TP should perform periodic reviews and internal audits and always keep audit trails for at least 5 years.

*Organizational requirements of a CIF to prevent market abuse*

***The general guideline requires the CIF to implement policies and procedures to ensure that automated activity does not give rise to market abuse.***

The supporting guidelines require that CIF to have knowledgeable staff monitor real time trading through algorithms including the use of alert systems.

*Organizational requirements for TP that provides DMA/SA to M/P/Us*

TP should have rules and procedures to ensure DMA/SA is compatible with fair and orderly trading. The TP must make such arrangements with the DMA/SA stressing that the responsibility remains with the DMA/SA for all trades using their ID. The MPU can provide DMS/SA provided that the systems and controls do not adversely affect the TP rules. The MPU should perform due diligence prior to provision of DMA/SA as well as monitor orders and have the ability to suspend or stop orders.

*Organizational requirements for CIFs that provide DMA/SA*

***The general guidelines states that in this case the CIF is responsible for its DMA/SA clients. Hence, the CIF should perform adequate due diligence and have pre trade controls to reject orders. Such controls could be applying its own pre/post trade controls, can be bought in from a vendor or the controls applied by the TP.*** However, the CIF remains responsible for setting key parameters. Furthermore, SA should never send orders to a TP without the order passing through the pre trade controls of the CIF.

*Contact and*

For further information please contact Marios Theocharides at [marios@theocharides.com](mailto:marios@theocharides.com).

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