

MEMO# 23282

March 2, 2009

IOSCO Issues Consultation Report on "Direct Electronic Access" Arrangements

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 6-09

INTERNATIONAL COMMITTEE No. 2-09

SEC RULES COMMITTEE No. 9-09 RE: IOSCO ISSUES CONSULTATION REPORT ON "DIRECT ELECTRONIC ACCESS" ARRANGEMENTS

The Technical Committee of the International Organization of Securities Commissions (IOSCO) has published a Consultation Report ("Report") on possible principles regarding direct electronic access ("DEA"). [\[1\]](#) The Report describes current DEA arrangements, as well as the regulatory approaches of Technical Committee member jurisdictions, and identifies and discusses the benefits, potential risks and concerns that are associated with the use of DEA arrangements.

The Report states that markets and intermediaries that are market members should have appropriate policies and procedures in place that seek to ensure that customers [\[2\]](#) granted DEA will not pose undue risks to the market and the relevant intermediary. According to the Report, the increased use of DEA has created substantial challenges including the potential that a customer may intentionally or unintentionally cause a market disruption or engage in improper trading strategies that may involve some elements of fraud and/or that may expose the intermediary to excessive credit risk.

The Report identifies three key areas where IOSCO is proposing developing principles to address the issues raised by the growth in the use of DEA: (1) pre-conditions for DEA; (2) information flow; and (3) adequate systems and controls. For each of these elements, the

Report identifies possible principles that would provide guidance in the DEA area.

Pre-conditions for DEA

- DEA customers should be required to meet minimum standards, including appropriate financial resources; familiarity with the rules of the market and ability to comply with the rules of the market; knowledge of the order entry system which the customer is permitted to utilize; and proficiency in the use of that system.
- There should be a recorded, legally binding contract between the intermediary and the DEA customer, the nature and detail of which should be appropriate to the nature of the service provided.
- Where a DEA customer is permitted to sub-delegate its direct access privileges directly to another party (sub-delegatee), the responsible intermediary should seek to ensure that its contractual arrangements with its DEA customer allow it to identify the sub-delegatee if required by a market authority.

Information Flow

- Intermediaries should disclose to market authorities upon request and in a timely manner the identity of their DEA customers in order to facilitate market surveillance.
- Markets should provide member firms with access to all pre- and post-trade information (on a real-time basis) to enable these firms to implement appropriate monitoring and risk management controls.

Adequate Systems and Controls

- Markets should have rules in place that seek to ensure that intermediaries providing DEA access to their customers have adequate pre-trade controls to manage adequately the risk to fair and orderly trading.
- Intermediaries (including clearing firms) should have in place both regulatory and financial controls, including automated pre-trade filters, which can limit or prevent a customer from placing an order that exceeds existing position or credit limits on such a customer.
- Intermediaries (including clearing firms) should have adequate operational and technical systems to manage their DEA systems.

endnotes

[1] <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD284.pdf>. Comments on the Report are due to IOSCO no later than May 20, 2009.

[2] The Report defines “customer” as a person that is granted access to the market to transmit orders using either access through an intermediary’s infrastructure, or access without utilization of the intermediary’s infrastructure, whether or not that person is a licensed or registered intermediary.

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